



THOMAS J. MILLER
ATTORNEY GENERAL

Department of Justice

ADDRESS REPLY TO:
HOOVER BUILDING
DES MOINES, IOWA 50319
TELEPHONE: 515/281-5164
FACSIMILE: 515/281-4209

September 19, 2008

The Honorable Chester Culver
Governor, State of Iowa
State Capitol
Des Moines, IA 50319

Dear Governor Culver:

Some time ago, you wrote to request our assistance in addressing a series of legal questions concerning the operations of the Iowa Student Loan Liquidity Corporation ("ISL") and its relationship to the Iowa College Student Aid Commission ("Commission"). Guidance on the first four of those questions is provided in the memorandum attached to this letter. (Attachment 1.) The memorandum also gives a brief outline of legal authorities related to your fifth question and background information on ISL and the Commission. This letter is intended to provide a complete response to your fifth question.

The fifth question in your letter was the following: "Whether ISL's operations, as presently constituted, are sufficiently subjected to oversight by our state government, or whether some agency of state government should be vested with oversight powers and responsibilities?"

The simple answer is that ISL's operations should be, and since the date of your letter have been, subjected to greater oversight by state government. As you know, the most notable change in the oversight of ISL (and other student loan lenders and institutions of higher education) was House File 2690 which became law with your signature on May 5, 2008. HF 2690 is landmark legislation that establishes important new protections for student borrowers and their families.

(We note that there is extensive federal regulation of ISL with regard to federal loans. Congress recently enacted legislation applicable to federal loans that contains protections very similar to protections contained in HF 2690, which is applicable to all student loans. See Higher Education Opportunity Act of 2008 (P.L.110-315, August 14, 2008)).

But, the complete answer to your question is much more complex. While HF 2690 is comprehensive, it does not address all of the issues relevant to the proper oversight of ISL's operations. Our task in providing you sound advice was to fully consider ISL's operations and determine what oversight is needed beyond the new statute.

Process Used to Review ISL

In preparing a response to your inquiry, we initially considered only looking forward and making recommendations for additional oversight of ISL. However, to accurately determine whether ISL was sufficiently subject to state government oversight, we concluded it was necessary to evaluate ISL's past lending practices and operations. To make appropriate recommendations on oversight going forward, we needed to understand how ISL operated in the past.

The student loan industry is complex. After collecting information, conducting an internal review, and drawing preliminary conclusions, we decided that we needed an expert to assist us in evaluating ISL's past activities in a more thorough and technical manner. Fortunately, we were able to retain (on a pro bono basis), one of the nation's leading experts on the student loan business -- Mark Kantrowitz. Mr. Kantrowitz, whose resume is found on page 40 of the attached report (Attachment 2), donated countless hours working with us to produce a report evaluating ISL. We were truly fortunate to have someone with his knowledge, expertise, and dedication to students assist us in this project. We are grateful for his outstanding help.

The following process was used to prepare the report: Mr. Kantrowitz compiled a list of data he needed from ISL, and ISL was very cooperative in providing an extensive amount of data in response. Mr. Kantrowitz analyzed the information and wrote a report delineating his findings and recommendations. The report was provided to ISL for comment. ISL made numerous written comments and suggestions for changes. A conference call was convened with representatives of ISL wherein they orally responded to the report. Mr. Kantrowitz considered their requested changes and revised his report where he thought appropriate.

We believe the report is an excellent piece of work. It is grounded on voluminous data and expert analysis of the highest level. Moreover, we think the report represents a balanced, unbiased point-of-view, which was our goal beginning with the selection of Mr. Kantrowitz as our expert and continuing throughout the process. We are confident that the report is a solid basis on which we can make recommendations to you. The report is attached.

Standards of Conduct to Which ISL Should be Held

Before turning to the findings and recommendations of the report, it is necessary to discuss the standards of conduct to which ISL should be held. Simply stated, ISL is not a typical student loan lender. It is an organization that should be held to the highest standards of conduct for several reasons.

ISL is a Nonprofit Corporation

ISL is a nonprofit corporation, subject to the Revised Iowa Nonprofit Corporation Act, Iowa Code chapter 504. In return for an exemption from income taxes, nonprofit corporations

are to be organized and operated exclusively for educational, religious, charitable, scientific, literary, and similar purposes. See 26 U.S.C. § 501(c)(3). ISL, as a nonprofit corporation, is organized and operated for an educational purpose, that is, providing financial assistance so Iowa students can better afford higher education. Specifically, ISL states that its mission is "to help students obtain the resources necessary for a post-secondary education."

Under Iowa law, the loyalty of ISL and its directors must be to the fulfillment of ISL's charitable mission. See Iowa Code § 504.831. ISL does not hold allegiance to shareholders. Its ultimate goal is not the pursuit of profits for distribution. Rather, ISL's guiding principle should be to serve Iowa student borrowers as best it can.

Without doubt, ISL must conduct its overall operation in a successful and business-like way so it has adequate resources and capacity to provide student financial assistance on an on-going basis. ISL must be efficient, prudent, and exercise proper business judgment. But, in doing so, ISL cannot neglect its stated nonprofit purpose: to improve the financial ability of Iowa students to obtain a higher education.

ISL is to Act in the Public Interest

ISL should be subjected to the highest standards of conduct not only because of its nonprofit status, but because it is an organization that was established and exists to serve public, not private, interests.

ISL is not a state agency or instrumentality. It was created as an entity that would be separate and independent from the State of Iowa, so the State would not be liable for ISL's indebtedness. Yet ISL has many connections to the State. Governor Robert Ray wrote the letter asking for the creation of ISL. According to ISL's articles of incorporation, the Governor appoints ISL's board of directors. ISL has been designated by the State as Iowa's secondary market for student loans. ISL is authorized by state law to issue tax-exempt bonds. ISL makes its private "Partnership" student loans pursuant to agreements with the Commission. (The Commission is authorized to make such agreements under Iowa Code section 261.38(5)).

All of these relationships with the State are intended to create an organization that is accountable to the public and acts in the best interests of the public. The public interest demands that ISL always strive to conduct itself in a manner that is beyond reproach.

Findings and Recommendations of the Report

We now turn to Mark Kantrowitz's report. We will highlight the most important concerns raised by Mr. Kantrowitz, discuss his recommendations, describe ISL's response to the recommendations, and indicate what steps are needed to address the concerns in the future.

ISL's Marketing of Loan Products and ISL's Lending Practices

The report raises serious questions about ISL's marketing of loans to students and its lending practices. Overall, the report concludes that ISL's practices favored the goals of increasing access to loans and offering families a choice of loans over the goal of making the lowest cost loans available to each of its borrowers. This emphasis on access and choice over affordability resulted in some ISL student borrowers paying more than they would have paid if they had pursued other loans for which they were qualified.

As the report notes, increased access to student loans is a laudable mission for an organization like ISL. In fact, when the Iowa Legislature authorized the establishment of ISL's private loan program (now called the "Partnership" loan program), "access" to "alternative education loan programs" was stated as the objective. See Iowa Code § 261.38(5). However, as the report recommends, if ISL fashions programs that sacrifice affordability for some borrowers to benefit access for other borrowers, this should be a policy clearly articulated by the board of directors. Moreover, this policy choice should be fully disclosed to prospective borrowers who might be disadvantaged.

All of this must be seen in the context of Iowa being one of the states with the highest level of student loan indebtedness. The future of many Iowa students is burdened by a mountain of student loan debt. It is critical that students and their families have the most complete understanding of the student loans for which they qualify so they can obtain the best deal possible.

Here are some of the specific marketing and lending practices that were found to be troubling in the report:

(1) ISL marketed its loans as lowest-cost loans. There is no question that ISL's private loans were low-cost loans compared to many private lenders. However, ISL often made claims and marketed its loans as "lowest cost loans." As the report demonstrates, this was not always the case when comparing ISL's private loans with other private loans. And, it was almost never the case when comparing ISL's private loans with federal student loans.

Recommendation 2 on page 35 of the report suggests that ISL refrain from using superlative language to describe its private loans. ISL has agreed to do this. ISL has also agreed to generally enhance the quality of its marketing disclosures by improving its website and making its disclosures more readable. (Recommendations 6 and 7 on page 36 of the report.)

Our office will continue to monitor ISL's marketing disclosures.

(2) ISL's disclosures did not adequately promote federal loans. It is widely accepted that federal loans are almost always less expensive than private loans. This would include

Stafford loans made to students, Parent PLUS loans made to the parents of dependent undergraduate students, and Grad PLUS loans made to graduate and professional students.

The report documents that ISL's private loan products were almost always more expensive than federal loans for which the student was eligible. Yet, through the years, ISL fell short by not routinely including disclosures in its marketing materials (especially in marketing materials for the private student loans) stating that federal loans, both Stafford and PLUS, were usually less costly than ISL's private loans. Moreover, through the years, ISL did not routinely encourage students and their parents to exhaust federal loan opportunities before applying for ISL's private loans.

Recommendation 1 on page 35 of the report states: "ISL should include a disclosure statement in its marketing materials and website that the Stafford loan is less expensive than ISL's private loan products." ISL has agreed to this recommendation, stating "ISL is willing to add clarifying language to its marketing materials and website that would further bolster the concept of using federal eligibility before looking into private borrowing, including a statement that Stafford loans are generally, or usually, less expensive than private loans."

HF 2690 also addresses this issue. It requires a lending institution on a preferred lender list, such as ISL, to present a lengthy disclosure statement to students applying for a private loan. One of the items that must be disclosed is "[i]nformation comparing federal and private educational loans." See Iowa Code § 261E.5(3)(h). Our office is given the responsibility to develop a model disclosure for this purpose.

Additionally, under HF 2690, the Iowa Superintendent of Banking is directed to review ISL's "procedures to inform students, prior to the submission of an application to [ISL] for a loan made by ISL, about the advantages of loans available under [federal law] for which the students may be eligible." Iowa Code § 7C.13(6)(b).

(3) ISL did not do enough to be sure federal loan eligibility was exhausted. This concern about past ISL lending practices is similar to the last point about disclosures. The report indicates that, through the years, ISL could have done more to assure that students exhausted available federal assistance before ISL extended a private loan to the student.

Recommendation 8 on page 36 of the report states "ISL should require borrowers to have exhausted their subsidized and unsubsidized Stafford loan eligibility before becoming eligible for ISL's private student loan." ISL's response to this recommendation was that "ISL's policies and procedures already reflect this recommendation. . . . However, in order to be a leader in this area for the benefit of students, ISL will redouble its efforts to enforce the certification process [with educational institutions] and further enhance its existing disclosures that warn students to utilize Stafford loans and other federal aid before applying for a private student loan."

HF 2690 also comes into play in this regard. The new statute places burdens on educational institutions to take steps to assure that students use federal loans before private loans. First, Iowa Code section 261E.5(1) requires an educational institution which has entered into preferred lender arrangement with a lender to inform borrowers of all available state and federal government financing options, including options that are more favorable to the borrower than the private lender's educational loans. Second, Iowa Code section 261E.5(2) prohibits the bundling of private educational loans unless the borrower is ineligible for federal student aid, has exhausted available federal student aid, does not desire or refuses to apply for federal student aid, or has not filled out a free application for federal student aid ("FAFSA") and the bundling of private loans is fully disclosed.

ISL's Representations regarding Consolidation Loans and Borrower Benefits

The report discusses advertisements that ISL used in two areas that were particularly troubling -- consolidation loans and borrower benefits accruing with timely payments.

(1) Consolidation Loans. In the past, ISL distributed advertisements for student consolidation loans which included statements and comparison charts that had the tendency or capacity to mislead potential borrowers through claims that the consolidation loans would result in monetary savings to borrowers. The advertisements could easily be read by a prospective borrower to mean that they would save money by consolidating loans, when, in fact, the borrower would almost always spend much more to pay off the loans because the term was extended to 20 or even 30 years. (Copies of some of the advertisements are appended to the Kantrowitz report.) The ads featured claims of big savings for students in large type size and pictures of borrowers offering glowing testimonials; then, in small type size in footnotes, the ads attempted to clarify that borrowers, in the end, would pay more.

These advertisements raise questions under Iowa's Consumer Fraud laws. Yet in our dialogue with ISL, it was slow to understand and acknowledge the problems with the ads. ISL asserted that their marketing was not deceptive and was superior to the advertisements used by other private lenders. After several meetings and discussions with this office, ISL agreed to resolve the issue by signing a Memorandum of Understanding (MOU). The MOU (Attachment 3) describes our concerns with ISL's marketing of consolidation loans. It also contains an agreement by ISL that, in the future, it will use truthful, clear, concise, and readily understandable language in consolidation loan advertisements. (It should be noted that ISL is not currently offering consolidation loans.)

(2) Borrower Benefits. ISL advertised beneficial loan terms to borrowers who made timely payments over certain periods of time, including lowered interest rates. However, the ads did not clearly and conspicuously disclose the conditions placed on obtaining the benefits. In the MOU referenced above, ISL agreed that in any advertisement making claims that ISL will lower interest rates or otherwise modify loan terms to benefit borrowers, ISL will state any material

condition on the availability of the benefits in language that is truthful, clear, concise, and readily understood by borrowers.

ISL's Relationships with Colleges and Universities

In the past, ISL had relationships with Iowa's colleges and universities that were inappropriate and presented potential conflicts of interest.

(1) ISL's Reimbursement Program. According to the Kantrowitz report, "ISL maintained a program in which it made payments to as many as 50 colleges to reimburse the colleges for expenses incurred by the colleges in administering ISL's loan programs, such as counseling borrowers, certifying loan applications and disbursing loans, all functions that are normally considered part of a college's administrative capabilities. The reimbursements were based on the number of borrowers and the staff time spent per borrower [although colleges were not required to substantiate the time spent per borrower]. . . . In effect, ISL was paying a fee for every application it received, roughly \$25 per loan application at private colleges and \$15 per loan at community colleges." Over a five year period, ISL paid a total of \$1,513,223 to colleges.

ISL also made payments to at least one alumni association, namely, the Iowa State University alumni association, to market ISL consolidation loans.

The report states "[t]his reimbursement program may not have violated the prohibited inducement rules in the Higher Education Act of 1965 because the payments were made in connection with a private student loan program and not a federal education loan program. However, while the reimbursement program may have been technically legal at the time, it presented colleges with a potential conflict of interest between their pecuniary interests and the best interests of prospective borrowers."

Many colleges and universities chose not to participate in the program, including the University of Iowa and the University of Northern Iowa.

Initially, ISL was reluctant to acknowledge the impropriety of, or even the appearance of impropriety created by, the reimbursement program. ISL vigorously defended the program even though, at the time, relationships between private lenders and colleges were being examined and called into question by state attorneys generals and others across the country. ISL discontinued the program in mid-May of 2007.

Arrangements between lenders and colleges like ISL's reimbursement program are no longer legal after the enactment of HF 2690. Under the new law, employees of colleges and universities (including employees of associated alumni associations) who work in a financial aid office or have direct responsibility with respect to educational loans are prohibited from soliciting or accepting gifts from a student loan lender. See Iowa Code § 261E.3(1). The

definition of "gift" is broad and would clearly include payments like those made under ISL's reimbursement program. See Iowa Code § 261E.1(5).

(2) Other Arrangements with Schools. During the summer of 2007, this office conducted a survey of 56 Iowa colleges and universities to collect information about relationships between the educational institutions and student loan lenders, including ISL. The survey disclosed relationships between ISL and the schools which raised concerns that ISL was offering benefits that could lead the schools to inappropriately steer more loans to ISL.

First, employees of Iowa colleges, universities, and community colleges, including financial aid office directors and staff, were recruited and paid expenses by ISL to serve on ISL's board of directors and various ISL advisory boards. Additionally, employees of schools, including financial aid office employees, were paid by ISL to review scholarship applications, process ISL loan applications, conduct ISL presentations to Iowa high schools, and provide consulting services related to ISL data programs.

HF 2690 now prohibits relationships of this sort, if the relevant school employee works in a financial aid office or has direct responsibilities with respect to educational loans. See Iowa Code § 261E.3(6) and (7).

Second, ISL provided various goods and services at no cost to schools, including printing, gift baskets, meals, trips, tickets/passes, office supplies, and temporary staffing to process applications, answer phones, and enter data.

Again, HF 2690 now bans most activities of this sort. School employees who work in a financial aid office or have direct responsibilities with respect to educational loans are prohibited from soliciting or accepting any gift from a student loan lender. Iowa Code § 261E.3(1). The definition of "gift" includes a gratuity, favor, discount, entertainment, item having monetary value of more than a de minimus amount, gift of services, transportation, lodging, or meals. Iowa Code § 261E.1(5). Moreover, employees of a lender on a preferred lender list are not allowed to staff a school's financial aid office or call center or prepare any of the school's materials related to educational loans. Iowa Code § 261E.4(3).

ISL's Iowa College Access Network

ISL operates an Iowa College Access Network. According to ISL's website "[t]he mission of the Iowa College Access Network (ICAN) is to help individuals attain their education and career goals. ICAN operates two College Planning Centers [CPCs] in West Des Moines, Iowa, and in Cedar Rapids, Iowa, which provide free information and support to a diverse population of students and their families as they plan, apply, pay for and succeed in college."

The obvious concern about a lender like ISL providing information about financing a college education is the risk that the lender will not give objective information and will favor its

loans over the loans of other lenders, including the federal government. In December of 2007, ISL sent a memorandum to this office which reported that ISL had "taken further steps to safeguard student loan information and verify that it is adhering to the board's policies governing the objectivity of the unit [i.e. ICAN]." The memorandum included an attachment which listed procedures ISL would follow to guarantee the "neutrality of services" offered by ICAN.

While these procedures are laudable, the Kantrowitz report discloses that during the period 2001-2007, ISL paid ICAN and CPC employees bonuses based on the number of ISL borrowers. The report rightly states "[t]his incentive to increase the number of ISL borrowers is inconsistent with the goal of maintaining ICAN and CPS as objective and neutral resources for Iowa students. It presents a clear conflict of interest." Moreover, as the report explains, commission-based compensation for federal loans could potentially be construed as a violation of the federal rules concerning inducements.

ISL initially did not acknowledge a problem with these employee bonuses. In a letter to this office, ISL stated, "[a]t no time did staff performance adjustments relate to the generation of any specific loan product. ISL has never paid any employee bonus or incentive pay which would cause employees to promote any ISL product to the detriment of the borrower." Recommendation 12 on page 36 of the report suggests that "ICAN and CPC compensation should not be dependent in any way on the number of ISL loan applications, borrowers, or funded loans, nor on any ISL-specific performance measures." In response, ISL stated that it agreed with the recommendation and that its performance plans "now clearly reflect the substance of the recommendation."

An idea that is worthy of consideration is to completely transfer the college planning and public information functions from ISL to the Commission. Under that approach, ISL would discontinue most all of their activities in the area and the Legislature would direct the Commission to assume these duties.

The Legislature has already directed the Commission to play a role here. Iowa Code section 261.2(3) directs the Commission to "[d]evelop and implement, in cooperation with the state board of regents, an educational program and marketing strategies designed to inform parents about the options available for financing a college education and the need to accumulate the financial resources necessary to pay for a college education. The educational program shall include, but not be limited to, distribution of informational materials to public and nonpublic elementary schools for distribution to parents and guardians of five-year and six-year old children."

Assigning college planning and public information functions primarily to the Commission would eliminate any risk that the ICAN unit does not act in a neutral fashion. It would also eliminate any overlap in existing public information programs administered by ISL and the Commission. It would allow ISL to redirect money spent on the ICAN unit to other uses, but could require additional resources for the Commission.

Transparency and Accountability to the Public

Another important aspect of oversight of ISL is accountability to the public directly. Essential to public accountability is the transparency and openness of ISL's operations. Since we received your letter, several things have occurred to increase the public's ability to monitor ISL.

Reports and Audits

ISL is now submitting additional reports and audits for public inspection.

The State Auditor issued an audit concerning ISL on October 25, 2007. The Auditor made several recommendations "to provide additional public awareness of ISL's activities." First, the Auditor recommended that ISL be required to file the annual audit of ISL with the Auditor where it would be a public record and available for public review. Second, the Auditor recommended that ISL be required to prepare an annual or biennial report to be filed with the Governor and the General Assembly that discusses operations, financial status, outlook for the future, and how ISL activities serve its non-profit mission. In November of 2007, ISL's board of directors agreed to both of these recommendations.

HF 2690 includes new reporting requirements. ISL is required to submit an annual report to the Governor and the General Assembly "setting forth its operations and activities conducted and newly implemented in the previous fiscal year related to use of the allocation of [the state bonding authority] and the outlook for the future. The report shall describe how the operations and activities serve students and parents." Iowa Code § 7C.13(2). The same section provides that "[t]he annual audit of [ISL] shall be filed with the office of auditor." *Id.*

Public Record and Open Meetings

The memorandum on your first four questions (Attachment 1) discusses the extent to which ISL is subject to Iowa's public records and open meetings statutes. The memorandum lays out statutory changes in HF 2690 which now require ISL to comply with Iowa's openness statutes when ISL deliberations or records relate to the issuance of tax-exempt bonds.

The State Auditor report mentioned above recommended that the Legislature fully subject ISL to the open meetings statute, "provided ISL could maintain confidentiality of proprietary information which could be beneficial to its competitors if publicly disclosed." The Legislature in HF 2690 did not go as far as the Auditor recommended.

In the interest of transparency and public accountability, we think it would serve ISL well to voluntarily comply with the open meetings and public records statutes to the maximum extent possible. ISL should only withhold public access if a specific, identified business or other legitimate reason prevents disclosure of information to the public.

Iowa College Student Aid Commission and ISL

The memorandum answering your first four questions (Attachment 1) also discusses the role of the Commission as a regulator of ISL. When reviewing ISL's lending activities, it is particularly important to review the Commission's oversight role with respect to ISL's private "Partnership" loan program.

In 1995, the Legislature enacted legislation stating "[t]he commission may enter into agreements with [ISL] in order to increase access for students to education loan programs that the commission determines meet the education needs of Iowa residents. . . . In accordance with those agreements [ISL] may issue bonds, notes, or other obligations to the public and others for the purpose of funding the alternative education programs." Emphasis added Iowa Code § 261.38(5). The Commission could exert its authority under this section and impose conditions on ISL's lending practices with respect to ISL's Partnership loan activities. For example, the Commission could bind ISL to a code of conduct for Partnership loan lending.

However, instead of the Commission imposing conditions on ISL, we believe it would be preferable if the Commission and ISL shared a common vision on how the State of Iowa can best assist Iowa's students to afford a higher education. We would be remiss if we did not comment on what appears to be an on-going, mutual distrust and lack of cooperation between the Commission and ISL. A poor relationship between the two entities is counter-productive to the goals of efficiency, innovation, and joint problem-solving. The Governor appoints a majority of the members of the Commission and all of the directors of ISL. It seems that the two organizations should share the Governor's goals in this arena and work together to achieve those goals.

Conclusion

The policies and practices of ISL examined in this letter, considered as a whole, have been troubling. ISL's shortcomings were numerous, affecting a broad swath of its operations -- marketing, lending, dealings with schools, and college planning activities. Moreover, ISL did business in this manner for many years. The key point, of course, is that ISL's actions had negative consequences for Iowa students and their families. While the consequences cannot be quantified, we conclude that many Iowa students who took out loans with ISL paid, or are paying, more than they would have paid if they had pursued other loans for which they were qualified.

We also were disappointed with ISL's reactions to our criticisms and suggestions for change during the course of our review. On many issues, ISL was initially defensive and reluctant to admit the need for reform. ISL often defended its practices by comparing them with the practices of other private student loan lenders, saying that ISL was only following industry practice or was acting better than other private lenders. We, of course, are concerned about the practices of other lenders from a consumer protection point of view. But we repeatedly had to

reinforce our view with ISL that it should be held to higher standards than its private for-profit competitors.

To its credit, ISL, in the end, agreed to resolve almost all of the issues discussed in this letter in a positive, constructive manner. ISL now readily acknowledges that it should be held to the highest standards of conduct. It has agreed to abide by a model code of conduct (which is a model code all student loan lenders in Iowa should adopt.) The code of conduct is attached. (Attachment 4.)

Despite the foregoing, ISL has done good things for students. ISL has adopted many policies that help students. Here are a few examples: As mentioned above, ISL has focused on providing access to loans for less creditworthy borrowers. Because of this emphasis, ISL undoubtedly has made loans accessible to many Iowa students who otherwise would not have been able to receive private loans. On Stafford loans, ISL was one of the first lenders in the nation to pay the 3% up-front origination fee for students. On federal PLUS loans, ISL was one of the few lenders that offered to forgive the first six to nine months of interest (this being a work-around for federal regulations prohibiting payment of up-front fees for parents on federal PLUS loans). On federal consolidation loans, ISL provided borrower benefits after six on-time payments, a number that was much lower than the benefits offered by most competitors.

When questions about ISL first surfaced in February of 2007, some speculated that an investigation of ISL would unearth a scandal "like CIETC." We can emphatically state that the failings of ISL discussed here in no way resemble the wrongdoing disclosed in the CIETC matter. There are no allegations that ISL's management, employees, or board of directors engaged in any criminal conduct. There are no allegations that ISL's management, employees, or board of directors improperly diverted ISL resources or acted for improper personal financial gain. (Both the State Auditor and Mr. Kantrowitz reviewed the compensation of ISL's executives and found it to be reasonable.) There are no allegations that ISL's management, employees, or board of directors acted with ill-will or bad intentions. On the contrary, we believe those connected with ISL are Iowans of good character acting in good faith.

What, then, went wrong at ISL? While we cannot draw any conclusions with certainty, we believe that ISL went off-track and began acting less like a nonprofit corporation with special ties and responsibilities to the State of Iowa and more like a for-profit business. It appears that ISL unduly elevated the goals of increasing its competitive advantage, market share and loan portfolio size over its mission of always striving to do the best for its student borrowers. ISL fell short in achieving the high standards of conduct which we think Iowans expect and deserve.

We have explained many sources of oversight for ISL -- the federal government, the state auditor, the attorney general (by virtue of HF 2690, consumer protection laws, and nonprofit laws), the state superintendent of banking, the Commission, and the public. To assure that ISL

The Honorable Chester Culver
September 19, 2008
Page 13

remains headed down the correct path, we believe the ultimate burden of oversight must rest where it should rest - with ISL's board of directors appointed by the Governor. The directors must issue strong and clear direction to ISL management to act in accordance with the highest standards of conduct. And the directors must continue to monitor the performance of management so those standards are maintained. This will require directors with great expertise, dedication of purpose, and willingness to commit time and energy to this important task.

If our office can be of further assistance on these issues, please do not hesitate to contact us.

Sincerely yours,

A handwritten signature in black ink, appearing to read "T. J. Miller", with a long horizontal line extending to the left.

Thomas J. Miller
Iowa Attorney General



THOMAS J. MILLER
ATTORNEY GENERAL

Department of Justice

ADDRESS REPLY TO:
HOOVER BUILDING
DES MOINES, IOWA 50319
TELEPHONE: 515/281-5164
FACSIMILE: 515/281-4209

MEMORANDUM

TO: Chester J. Culver, Governor of Iowa
James Larew, General Counsel

FROM: Julie F. Pottorff, Deputy Attorney General
Susan Aden, Assistant Attorney General

RE: Iowa Student Loan Liquidity Corporation

DATE: September 23, 2008

ATTACHMENT 1

You have requested that our office address several questions concerning the Iowa Student Loan Liquidity Corporation ("ISL"), a nonprofit corporation created in 1979 to serve as an "eligible lender" under federal law in order to acquire and service student loan notes. In this memorandum we summarize the relevant background information concerning the creation of ISL and then address four of the five questions posed to our office in your letter to Attorney General Tom Miller. The Attorney General has separately examined your fifth question concerning the need for oversight of ISL. A report in response to your fifth question is enclosed separately.

BACKGROUND

Your questions arise in the context of the federal Higher Education Act of 1965 (HEA), as amended, which includes the Federal Family Education Loan Program (FFELP). FFELP provides for federal insurance of student loans, or, alternatively, for federal reimbursement of guaranty payments made on student loans in states where a state guaranty agency makes payments on student loans pursuant to federal law. See 20 U.S.C. chapter 1071 et seq. The Iowa College Student Aid Commission ("the Commission") is a guaranty agency under federal law and a state agency under Iowa law.

Congress provided a process whereby each State could designate a single, nonprofit private entity to issue tax-exempt "qualified scholarship bonds" for the purpose of obtaining funds to finance the acquisition and holding of student loans originated by other lenders under federal law. See 26 U.S.C. § 150 (d)(2) and 20 U.S.C. § 1085(d)(1)(D). These nonprofit private entities are considered "eligible lenders" under federal law with respect to secondary market activities.

State government authorized the creation of ISL in 1979 in the context of this federal statutory backdrop. The Commission adopted a resolution on May 14, 1979, noting its "duty to implement all possible assistance to eligible lenders for the purpose of easing the workload entailed in participation in the guaranteed student loan program" and its "power to approve lenders as eligible lenders for making guaranteed loans." The Commission stated that the organization of a not-for-profit corporation could be expected to increase lender participation in the Iowa guaranteed student loan program and, in turn, the "acquisition and servicing of student loan notes" by a not-for-profit corporation could be expected to "ease the workload of eligible lenders entailed in their participation in the guaranteed student loan program." With these stated goals, the Commission resolved that a nonprofit corporation should be organized in compliance with federal law and named the Student Loan Liquidity Corporation.

The Commission expressly resolved that ISL "shall be established . . . exclusively for the purpose of providing funds for and acquiring student loans. . . ." and the Commission directed the incorporators to provide for an eleven member board of directors appointed by the Governor to include representatives of the Commission, the Iowa Regents Institutions and the Superintendent of Banking.

Approximately one month later, on June 23, 1979, Governor Robert Ray issued a letter to the prospective incorporators of ISL requesting they "assist the State of Iowa by making arrangements necessary for providing a statewide student loan acquisition program through a not-for-profit corporation pursuant to the provisions" of federal law. Governor Ray specifically requested that the incorporators "organize and establish" the not-for-profit corporation pursuant to federal law and "obtain an eligible lender number from the Office of Education, United States Department of Health, Education, and Welfare, as the single, not-for-profit private corporation (agency) designated by [Governor Ray] and the College Aid Commission of the state of Iowa." Further, Governor Ray requested that the corporation "be established and operated exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965, as amended, including loans directly insured by the federal government and loans insured by the Iowa Guaranteed Student Loan Program, subject to reinsurance by the federal government."¹

¹ The Articles of Incorporation for ISL have been amended several times since 1979. The current Articles of Incorporation state that after May 19, 1992, the corporation is "organized exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965, as amended, *or such supplemental student loan programs as may be authorized from time to time by the Iowa State Legislature, such programs as shall be deemed necessary or desirable by the Board of Directors of the Corporation and consistent with its charitable and educational purposes (including programs of any United States department or agency) and to devote any income (after payment of expenses, debt service and the creation of reserves for the same) to the purchase of additional student loan notes or to pay over any income to the State of Iowa.*" (Emphasis added). In 1995, nearly twenty years after ISL was formed, ISL began to offer private loans to students through the Partnership Loan Program. This program is authorized

Accordingly, ISL was created in 1979 as a nonprofit corporation to serve as an "eligible lender" under federal law for the exclusive purpose of acquiring student loan notes. We now turn to your specific questions.

QUESTIONS

1. Whether, without any statutory authority, the Governor should be appointing the members of the ISL board of directors?

Since ISL was formed in 1979, no statute has been enacted that codifies appointment of the board of directors by the Governor of Iowa as provided in the Articles of Incorporation of ISL. In fact, there are only a few direct references to ISL in Iowa statutes. For example, the state ceiling for bonds issued for various purposes includes a sixteen percent ceiling for qualified student loan bonds, but permits the Governor's designee, with the approval of ISL, to decrease this amount. Iowa Code § 7C.4A(3) (2007). Certain agreements between the Commission and ISL are expressly authorized by statute. Iowa Code § 261.38(5) (2007) ("The commission may enter into agreements with the Iowa student loan liquidity corporation in order to increase access for students to education loan programs that the commission determines meet the education needs of Iowa residents."). Until recently, the Commission's enabling act codified appointment of one member of the Commission to the board of directors of ISL. Iowa Code § 261.1(5)(2007) ("One member shall be a representative of the Iowa student loan liquidity corporation.").

We find no legal authority to suggest that the absence of a statutory directive deprives the Governor of the power to appoint the directors as provided in the Articles of Incorporation. It is not uncommon for a governor to appoint directors of a private corporation that serves a government function. Although reported cases tend to focus on gubernatorial appointments that are authorized by statute, *see, e.g., Blue Cross and Blue Shield of Michigan v. Milliken, et al.*, 422 Mich. 1, 367 N.W.2d 1 (1983) (governor statutorily authorized to appoint eight public members to nonprofit health care corporation board of directors); *State ex rel. Eckles v. Woolley, et al.*, 302 Ore. 37, 726 P.2d 918 (1986) (governor statutorily authorized to appoint board of directors of corporation to manage workers' compensation insurance coverage), this does not mean that appointments by a governor to the board of directors of a private corporation must necessarily be authorized by statute.

under Iowa Code section 261.38 and is operated under a state license issued by the Division of Banking of the Iowa Department of Commerce. The statute authorizing this program vests the Commission with authority to determine if the program meets the educational needs of Iowa students. *See* Iowa Code § 261.38 (2007) ("The commission may enter into agreements with the Iowa student loan liquidity corporation in order to increase access for students to education loan programs that the commission determines meet the education needs of Iowa residents."). Recently, ISL discontinued the Partnership Loan Program due to financial market conditions.

Whether the Governor should continue making appointments to the board of directors is a political decision that is beyond the scope of our response to these questions. If the Governor discontinues making these appointments, the authority should be vested in another state official if ISL is to continue to be allowed to use the State's tax exempt bonding authority to issue qualified student loan bonds under federal law. See 26 U.S.C. §§ 150 (d)(2), 144(b)(1)(B).

2. Whether members of the board of directors of ISL should also, simultaneously, be serving on ISL and the Iowa College Student Aid Commission and/or the Iowa Board of Regents, or whether such dual membership constitutes impermissible conflicts of interest?

This question raises concerns about whether any seats on the ISL board of directors should be designated for a member of the Commission or a representative of the Board of Regents and whether a director who is also a member of the Commission or a representative of the Board of Regents faces conflicts of interest. The passage of legislation during the 2008 session of the General Assembly altered the composition of the board of directors. We note the recent legislative changes in the discussion that follows.

Designated Seats on the ISL Board of Directors

Designation of seats on the board of directors for a member of the Commission and a representative of the Iowa Regents Institutions² came directly from the requirements stated in the resolution passed by the Commission in 1979 that were included in the ISL Articles of Incorporation. Although you inquire about seats designated for a member of the Commission and a representative of the Regents Institutions, we also include a discussion of the seat designated for the Superintendent of Banking.

Both the Commission and the Superintendent have regulatory authority over the activities of ISL. Generally described, the Commission has authority to take action against ISL as an "eligible lender" if ISL is found to have engaged in prohibited conduct and to terminate agreements entered into with ISL pursuant to Iowa Code section 261.38 if ISL is in breach of the agreement or if the Commission determines that the loan programs authorized by an agreement no longer meet the education needs of Iowa residents. The Superintendent is vested with authority over the regulated loan license under which ISL conducts the Partnership Loan Program, a private loan program.

² Your question focuses on the Iowa Board of Regents; however, one director is dedicated more broadly to "Iowa Regents Institutions." Accordingly, this director could be selected from any of the institutions governed by the Regents, including the University of Iowa, Iowa State University, the University of Northern Iowa, the Iowa Braille and Sightseeing School, the State School for the Deaf, the Oakdale Campus or the Center for Disabilities and Development at the University of Iowa Hospitals and Clinics. Iowa Code § 262.7(1)-(7) (2007).

Appointment of public officials to serve on the board of directors of a nonprofit corporation over which they have regulatory authority raises concerns that oversight of the corporation may be weakened.³ In other contexts, common law principles of incompatibility prohibit a state official from serving in two offices where “one office is subordinate to the other” and “subject in some degree to its revisory power.” State ex rel. LeBuhn v. White, 257 Iowa 606, 611, 133 N.W.2d 903, 905-06 (1965). Although this common law doctrine applies only when analyzing two public offices, 1988 Iowa Op. Att’y Gen. 21, the doctrine raises the question whether it is good public policy to appoint state officials to the board of a private corporation over which the state officials have regulatory authority.

Iowa Code section 68B.2A addresses the situation in which any person who serves or is employed by the State engages in any “outside employment or activity” that is “in conflict with the person’s official duties and responsibilities.” This section sets out alternative definitions of “unacceptable conflict” that include the situation in which the “activity is subject to the official control, inspection, review, audit, or enforcement authority of the person, during the performance of the person’s duties of office or employment.” Iowa Code § 68B.2A(1)(c) (2007).

Applying this section, two of the seats on the board of directors were designated for state officials with some degree of “control” or “enforcement authority” over the activities of ISL. One seat was designated for a member of the Commission which, in turn, is vested with authority to establish standards for eligible lenders consistent with the requirements of the Higher Education Act of 1965. Iowa Code § 261.37(5) (2007). The rules of the Commission define ISL as a “lender” for the purpose of originating certain federal loans and authorize the Commission to limit, suspend, or terminate a lender under “terms consistent with . . . applicable state and federal law and regulations.” 283 Iowa Admin. Code 10.2(1)(b). Despite this connection between the duties of the Commission and the activities of the ISL board of directors, Iowa statutes had required that a member of the ISL board of directors serve on the Commission. See Iowa Code § 261.1(5) (2007) (“One member shall be a representative of the Iowa student loan liquidity corporation.”). During the 2008 legislative session the General Assembly addressed this problem by passing House File 2103 which removed a member of the ISL board of directors from the Commission and substituted “an individual who is repaying or has repaid a student loan guaranteed by the commission.” House File 2103, 82nd G.A., 2nd Sess., § 2 (Iowa 2008). This change in the composition of the Commission avoids the tension between membership on the board of directors of ISL and the exercise of regulatory authority over ISL. This change is a significant improvement.⁴

³ Nothing in the Iowa statutes governing nonprofit corporations restricts the pool from which the board of directors can be drawn. See Iowa Code § 504.802 (2007).

⁴ If ISL has not done so already, ISL should amend its articles of incorporation to delete the requirement that one director represent the Commission.

The Superintendent has regulatory authority over the license ISL holds to make regulated loans. The Superintendent is charged with the statutory responsibility to grant or refuse to grant a regulated loan license under which ISL conducts the Partnership Loan Program. See Iowa Code § 536.4 (2007). In addition, the Superintendent is vested with authority to investigate and examine the records of ISL as a licensee of the Division of Banking. Iowa Code § 536.10(1)(2007) (“For the purpose of discovering violations of this chapter or securing information lawfully required by the superintendent, the superintendent may at any time, either personally or by designee, investigate the loans and business and examine the books, accounts, records, and files of every licensee and of every person engaged in the business described in section 536.1, whether such person shall act or claim to act as principal or agent, or under or without the authority of this chapter.”). Evidence of certain violations of law discovered during an examination may be relied on to suspend or revoke the license. Iowa Code § 536.9 (1)(b) (2007) (“The superintendent may, upon at least twenty days’ written notice to the licensee stating the contemplated action and grounds, and upon reasonable opportunity to be heard, revoke any license issued hereunder if the superintendent shall find that . . . [t]he licensee has violated any provision of this chapter or any rule or regulation lawfully made by the superintendent under and within the authority of this chapter.”).

Contrary to Iowa statutes that had required a member of the ISL board of directors to serve on the Commission, Iowa statutes did not require the Superintendent of Banking to serve as a member of the ISL board of directors. Rather, Iowa statutes prohibited an employee of the Division of Banking from serving as a member of the ISL board of directors but, by negative implication, permitted the Superintendent of Banking to do so. See Iowa Code § 524.211(5) (2007) (“An employee of the banking division, *other than the superintendent* . . . shall not be a . . . director [of] any enterprise, person, or affiliate subject to the regulatory purview of the banking division.”) (emphasis added). During the 2008 legislative session the General Assembly addressed this problem by including in House File 2690 a prohibition against the Superintendent serving on the board of directors “of the qualified student loan bond issuer.” House File 2690, 82nd G.A., 2nd Sess., § 6(1) (Iowa 2008). As long as ISL is “the qualified student loan bond issuer,” therefore, the Superintendent is prohibited from serving on ISL’s board of directors.

By contrast, a representative of the Iowa Regents Institutions does not appear to have any authority over ISL. This position has been filled by a full-time employee of the Board of Regents who was later employed by Iowa State University and, more recently, has been filled by a member of the Board of Regents. Neither a full-time employee of the Board of Regents nor a full-time employee of an institution governed by the Regents nor a member of the Board of Regents itself is vested with regulatory authority over ISL or, in the terms of section 68B.2A, is vested with any “control, inspection, review, audit, or enforcement authority” over ISL.

Even though service on the ISL board of directors may cause state officials to be engaged in activities subject to their own regulatory authority, Iowa statutes do not demand that these officials discontinue serving on the board of directors. Section 68B.2A allows one of two remedies: either the official must “cease the outside activity” or the official must “publicly

disclose the existence of the conflict and refrain from taking any official action or performing any official duty that would detrimentally affect . . . the outside . . . activity.” Iowa Code § 68B.2A (2)(a)-(b) (2007). If a Commission member or the Superintendent had opted to publicly disclose a conflict and refrain from taking official action, a substitute could be appointed, if necessary, pursuant to Iowa Code section 17A.11(5). Although the statute leaves these choices to state officials, we believe that as a matter of sound public policy state officials who find themselves in this position should “cease the outside activity” and stop serving on the board of directors of any private corporation over which they have regulatory authority.

Conflicts of Interest

Apart from the question of whether any seats on the ISL board of directors should be designated at all for state officials or employees, those appointed to the board of directors may certainly face conflicts of interest as matters come before the board. We cannot speculate on the factual matters that may come before the board of directors in which an appointee may have a conflict of interest. We note that Chapter 504, the Revised Iowa Nonprofit Corporation Act, defines conflicts of interest and provides guidance for those circumstances under which a transaction may be approved even if a director has a conflict of interest. See Iowa Code § 504.833 (2007).

3. Whether members of the ISL board of directors should be receiving compensation for that service, particularly those who are state officials and whose membership is *ex officio*?

In responding to this question, we limit our focus to whether state officials or employees who serve on the ISL board of directors may receive compensation from ISL for their service. We have not investigated the amount of compensation paid by the corporation and express no view as to whether the amount of compensation paid to any of the directors is reasonable. See Iowa Code § 504.812 (2007).

Those appointed to the ISL board of directors who are state officials or employees and who receive a state salary must abide by the restrictions of Iowa Code section 70A.1. This section provides in relevant part that “all salaries . . . shall be in full compensation of all services, including any service on committees, boards, commissions or similar duty for Iowa government” Iowa Code § 70A.1(1) (2007). Of the seats held by state officials or employees, only those who receive a state salary are impacted by this restriction. This includes the Superintendent and may include a representative of the Iowa Regents Institutions, depending on whether the person appointed to this seat is selected from salaried officials or employees. The Superintendent is a salaried state official who serves as an *ex officio* director; however, a representative of the Iowa Regents Institutions may, but is not required to, be selected from salaried state officials or employees.

We have construed section 70A.1 in a number of opinions of the Attorney General. We have observed that this statute is intended to prohibit a state official or employee from receiving additional compensation for services performed during the same time period for which the person is already receiving state compensation. That is, the statute is intended to prohibit a person from being paid twice during the same time period. 1994 Op. Att'y Gen. 12; 1984 Op. Att'y Gen. 103. Generally, the issue has arisen in the context of a state official or employee who is appointed to serve on a state board or commission. For example, when a clerk of the district court, a state employee, was appointed to the State Racing Commission, we opined that the employee could not "receive remuneration for services on the State Racing Commission which are rendered during time for which he or she is reimbursed by the state for services as clerk of the district court." 1984 Op. Att'y Gen. 103.

These circumstances differ factually from your question in that service as a director for ISL is service on the board of a private corporation. Nonetheless, service on the board of a private corporation may be deemed a "similar duty for Iowa government" where the appointment is pursuant to the resolution by the Commission and the proclamation by Governor Ray in 1979, where the appointment is to a nonprofit corporation that has been formed to serve a public purpose as an "eligible lender" and where the appointment fills a seat specifically designated for a representative of state government. Under these circumstances, even though the appointment is not to a state board or commission, the appointment appears to be a "similar duty for Iowa government" within the meaning of section 70A.1. Accordingly, a state official or employee appointed to a seat on the ISL board of directors should not be compensated by ISL for service during the same time period for which he or she is paid by a state salary. To the extent that application of Iowa Code section 70A.1 is unclear as applied to service on the ISL board of directors, agencies whose officials or employees are appointed to the ISL board of directors should consider clarifying personnel policies.

In practical terms, this may mean that salaried government appointees to the ISL board of directors should either decline compensation from ISL or use accrued vacation leave when taking time away from state service or employment for ISL business. The accrual of vacation leave is a benefit of government service or employment. Iowa Code § 70A.1(2) (2007). Use of accrued vacation leave would not limit receipt of compensation from ISL for service performed during this time period.

4. Whether ISL's operation should be exempt from Iowa open meetings and public records statutes (Iowa Code Chapters 21 and 22) when it has access to and use of approximately 16% of Iowa's total state tax exempt bonding authority pursuant to Iowa Code section 7C.4A(3)?

Although you pose your question in terms of whether ISL "should be exempt" from the open meetings and public records statutes, we construe your question as whether these statutes apply rather than whether ISL should be subject to these statutes as a matter of public policy.

Open Meetings

The Iowa Open Meetings Law applies only to eight specifically defined “governmental bodies.” Iowa Code § 21.2(1)(a) - (h) (2007). Two of these governmental bodies are nonprofit corporations, but ISL does not fit within either of these definitions. Section 21.2(1) includes in the definitions of governmental bodies:

A nonprofit corporation other than a fair conducting a fair event as provided in chapter 174, whose facilities or indebtedness are supported in whole or in part with property tax revenue and which is licensed to conduct pari-mutuel wagering pursuant to chapter 99D or a nonprofit corporation which is a successor to the nonprofit corporation which built the facility. . . [and]

A nonprofit corporation licensed to conduct gambling games pursuant to chapter 99F.

Iowa Code § 21.2(1) (f), (g) (2007). Because ISL has nothing to do with pari-mutuel wagering or gambling games under Chapter 99F, these definitions do not apply.

ISL has had a policy of holding meetings of the board of directors open to the public. The ISL website lists the date, time and location of board meetings. See <http://www.studentloan.org/about-us/index.asp>. It is unclear whether the public is excluded from any portion of these meetings, or whether additional board meetings are held that are not open to the public.

Recent legislation specifically requires that the board of directors of the “qualified student loan bond issuer” conduct “deliberations or meetings” that relate to the issuance of bonds under chapter 7C in accordance with chapter 21. House File 2690, 82nd G.A., 2nd Sess., § 2(3) (Iowa 2008). Accordingly, to the extent that ISL is “the qualified student loan bond issuer” under Iowa Code chapter 7C, the board of directors must comply with the Open Meetings Law under chapter 21 when the board holds “deliberations or meetings” related to the bond issue.

Public Records

“Public Records” are defined to include “all records, documents, tape, or other information, stored or preserved in any medium, of or belonging to this state . . . or any . . . nonprofit corporation . . . whose facilities or indebtedness are supported in whole or in part with property tax revenue and which is licensed to conduct pari-mutuel wagering pursuant to chapter 99D, or tax-supported district in this state, or any branch, department, board, bureau, commission, council, or committee of any of the foregoing.” Iowa Code § 22.1(3) (2007). The definition also includes “all records relating to the investment of public funds including but not

limited to investment policies, instructions, trading orders, or contracts, whether in the custody of the public body responsible for the public funds or a fiduciary or other third party.” Id.

Any ambiguity regarding the application of the Public Records Law to ISL in its role as an issuer of tax-exempt bonds has been resolved by recent legislation that specifically identifies the ISL records that are subject to the Public Records Law under chapter 22. These records include: minutes of the meetings that are required to be open under House File 2690, section 3; data and written views or arguments regarding the Code of Conduct for covered institutions that are submitted under House File 2690, section 4; letters seeking approval from the Governor for issuance of tax-exempt bonds; and the published official statement of each tax-exempt bond issuance under chapter 7C. House File 2690, 82nd G.A., 2nd Sess., § 2(5) (Iowa 2008). To the extent that ISL issues tax-exempt bonds, therefore, the non-profit corporation must comply with the Public Records Law under chapter 22 with respect to the specified records related to the bond issuance.

Application of the Public Records Law more broadly to reach additional records held by ISL, or held by members of the ISL board of directors, cannot be resolved definitively in this memorandum.⁵ Arguably, the legislative specification in House File 2690 of the application of the Public Records Law to those records related to the issuance of tax-exempt bonds now defines the full scope of the records held by ISL that are subject to this law. See Weber v. Warnke, 658 N.W.2d 90, 96 (Iowa 2003) (“The rule recognizes that legislative intent - the polestar of statutory construction - is expressed by omission as well as by inclusion, and the express mention of one thing implies the exclusion of others not so mentioned.”). Certainly, the legislative removal of a member of the ISL board of directors from the Commission and the legislative removal of the Superintendent of Banking from the ISL board of directors resolves prospectively complex issues regarding application of the Public Records Law to these state officials while they are serving on the board of a corporation. Resolution of application of the Public Records Law to ISL in the future should be determined in the context of the particular records that may be requested.

5. Whether ISL’s operations, as presently constituted, are sufficiently subjected to oversight by our state government, or whether some agency of state government should be vested with oversight powers and responsibilities?

We are providing you with a brief outline of the legal authority of various governmental entities over the activities of ISL to consider in conjunction with the expert report on oversight issues that is separately enclosed. There are three general categories of governmental oversight related to ISL: (1) the federal and state laws regulating secondary market activities and lending;

⁵ Just over a year ago ISL filed suit to enjoin disclosure of records concerning ISL by the Board of Regents and by the Division of Banking in response to a request from the Des Moines Register. See Iowa Student Loan Liquidity Corp. v. Board of Regents, et al., Polk Co. No. CE56136. This suit has been settled.

(2) the consumer protection laws; and (3) the laws governing nonprofit corporations. We address briefly each of these three categories.

State and Federal Laws Governing Lending

The statutory framework for governmental oversight of the lending activities of ISL includes both federal and state agencies. The Secretary of the United States Department of Education (the Secretary) regulates “eligible lenders,” including nonprofit corporations that have been designated by the States for this purpose. Two state agencies have statutory authority to regulate the lending activities of ISL: the Commission and the Division of Banking. We discuss the scope of the existing authority of each of these regulatory entities briefly.

1. The Secretary

The Secretary can disqualify an eligible lender if the Secretary finds, after notice and an opportunity for hearing, that the eligible lender has violated federal law by engaging in any of the following activities:

offered, directly or indirectly, points, premiums, payments or other inducements to any educational institution or individual in order to secure applicants for loans;

conducted unsolicited mailings to students of student loan application forms, except to students who have previously received loans from such lender;

offered, directly or indirectly, loans as an inducement to a prospective borrower to purchase a policy of insurance or other product; or

engaged in fraudulent or misleading advertising.

20 U.S.C. § 1085(d)(5).⁶

The Secretary can impose civil penalties up to \$25,000 for each instance in which the Secretary finds, after notice and an opportunity for hearing, that a lender violated or failed to carry out HEA laws or regulations or substantially misrepresented the nature of its financial charges.

⁶ Recently, Congress enacted legislation that reforms regulation of federal loans to students. See Higher Education Opportunity Act of 2008 (P.L. 110-315, August 14, 2008).

The Secretary can limit, suspend, or terminate⁷ a lender from participating in FFELP if the lender violates any FFELP statutory provision or regulation, which includes disqualification as described above. See 34 C.F.R. § 682.700 et seq., 20 U.S.C. § 1082(h)(1). The Secretary also reviews each limitation, suspension or termination imposed on lenders by guaranty agencies pursuant to state regulations regarding FFELP that are substantially similar to the federal regulations governing these activities. See 20 U.S.C. § 1082(h)(2).⁸

2. The Commission

At the state level, the Commission, as a guaranty agency under the HEA, is required to enter into an agreement with the Secretary in which the Commission agrees to ensure that its loan guarantee program meets certain requirements, including the establishment, dissemination and enforcement of standards and procedures for: (1) ensuring that all lenders in the agency's programs meet the definition of "eligible lender" in 20 U.S.C. § 1085(d)(5) and have a written lender agreement with the agency; and (2) limiting, suspending and terminating school and lender participation in its programs. See 34 C.F.R. §§ 682.401(b)(19)(A) and (C).

Iowa Code Chapter 261 is the Commission's enabling statute for FFELP. The duties of the Commission include the duty to adopt rules establishing standards for educational institutions, lenders and individuals to become eligible institutions, lenders and borrowers. Iowa Code § 261.37(5) (2007). An eligible lender must meet the standards prescribed by the Commission and execute a lender participation agreement with the Commission.

⁷ A limitation allows the lender to remain eligible subject to compliance with specific conditions established by agreement with the Secretary or a guaranty agency. Suspension removes a lender's eligibility for a specified period of time or until the lender fulfills certain requirements. Termination removes a lender's eligibility for an indefinite period of time. Disqualification removes a lender's eligibility for an indefinite period of time by the Secretary on review of limitation, suspension or termination action taken against the lender by a guaranty agency.

⁸ At the time you submitted your questions to our office public attention had focused on allegations that ISL made payments to Iowa universities and colleges for processing student applications for loans. These payments made loans relatively less expensive for universities and colleges to administer. ISL also made payments to alumni associations that marketed consolidation loans to alumni. Our Consumer Protection Division sent letters to 56 Iowa universities and colleges to gather more information about these practices. State legislative changes in House File 2690 now prohibit Iowa universities and colleges and their alumni associations from accepting these payments. House File 2690, 82nd G.A., 2nd Sess., §§ 3(2), 5(3) (Iowa 2008). ISL discontinued this practice in 2007.

The Commission rules for FFELP are found in 283 Iowa Admin. Code 10.1 and 10.2. These rules adopt the FFELP rules and procedures of the HEA and Chapter 34 of the Code of Federal Regulations as the rules of the Commission. The Commission has the right, under rule 10.2(b)(2), to limit, suspend or terminate a lender under the terms of the agreement with the lender and applicable state and federal laws and regulations.

3. The Superintendent and the Division of Banking

The Division of Banking does not have the authority to regulate the secondary market activities of ISL. ISL expanded into the private student loan business through its Partnership Loan Program. See fn. 1, *supra*. The Division of Banking has regulatory authority only over this loan program.

In order to make consumer loans up to \$25,000 in Iowa, a lender must be a bank, must be a savings and loan or credit union, or must have a regulated loan license under Iowa Code Chapter 536 or Chapter 536A. ISL has held a regulated loan license under Chapter 536 since 1995. Accordingly, the Division of Banking regulates these loan products to assure compliance with truth-in-lending and usury laws; however, the Division does not examine or regulate ISL for compliance with HEA requirements for FFELP lenders.

The Superintendent has been given additional responsibilities under recent legislation that requires the Superintendent to “annually review the qualified student loan bond issuer’s total assets, loan volume, and reserves.” Further, the superintendent “shall review the qualified student loan bond issuer’s procedures to inform students, prior to the submission of an application to the qualified student loan bond issuer for a loan made by the qualified student loan bond issuer, about the advantages of loans available under Title IV of the federal Higher Education Act of 1965, as amended, for which the students may be eligible.” House File 2690, 82nd G.A., 2nd Sess., § 2(6) (Iowa 2008). Accordingly, the Superintendent has responsibilities to review the procedures by which ISL communicates with students about the advantages of federal loans.

Consumer Protection Laws

Student lenders and loan servicers, such as ISL, are also subject to the Consumer Fraud Act under Iowa Code section 714.16. The Consumer Fraud Act applies to practices relating to the sale, lease or advertisement of merchandise, which includes intangibles such as student loans. The Attorney General also enforces the Iowa Consumer Credit Code (“ICCC”) under Iowa Code Chapter 537. The ICCC incorporates the federal Truth in Lending Act. The Attorney General, therefore, may undertake an examination of the lending practices of ISL under either the Consumer Fraud Act or the ICCC. Consumer protection enforcement authority has been significantly enhanced by House File 2690 which includes, in addition to the ban on gifts from lenders to schools and school officials, regulation of preferred lender lists presented to students.

House File 2690, 82nd G.A., 2nd Sess., §§ 5-9 (Iowa 2008). Violations are enforced by the Attorney General through administrative hearings with fines up to \$5000 per incident against schools or lenders, and up to \$2500 per incident against school employees. House File 2690, 82nd G.A., 2nd Sess., §10 (Iowa 2008).

Nonprofit Corporations

In return for an exemption from income taxes, nonprofit corporations are to be organized and operated exclusively for educational, religious, charitable, scientific, literary, and similar purposes. See 26 U.S.C. § 501(c)(3). As a nonprofit corporation, ISL is organized and operated for the educational purpose of providing financial assistance so that Iowa students can better afford higher education. The Attorney General has authority over nonprofit corporations, including ISL. See Iowa Code ch. 504 (2007).

CONCLUSIONS

In summary, we respond to your questions about ISL as follows:

1. No express statutory authority is necessary for the Governor to appoint members of the board of directors in compliance with the Articles of Incorporation for ISL.
2. The appointment to the ISL board of directors of members who are public officials with regulatory authority over ISL weakens the oversight of the nonprofit corporation. Neither a member of the Iowa College Student Aid Commission nor the Superintendent of Banking should serve on the board of directors of ISL. Recent legislative enactments have removed a member of the board of directors of ISL from the Iowa College Student Aid Commission and have prohibited the Superintendent of Banking from serving on the board of directors of ISL.
3. A state official or employee appointed to a seat on the ISL board of directors should not be compensated by ISL for attending meetings during the same time period for which he or she is paid a state salary.
4. The Iowa Open Meetings Law does not apply to ISL, except when ISL is "the qualified student loan bond issuer" under Iowa Code chapter 7C. In this circumstance, the board of directors must comply with the Open Meetings Law under chapter 21 when the board of directors holds "deliberations or meetings" related to the bond issue. The Iowa Public Records Law applies to specific records related to issuance of tax-exempt bonds under chapter 7C. These records include: minutes of the meetings that are required to be open under House File 2690, section 3; data and written views or arguments submitted under House File 2690, section 4, regarding the Code of Conduct for covered institutions;

letters seeking approval from the Governor for issuance of tax-exempt bonds; and the published official statement of each tax-exempt bond issuance under chapter 7C.

5. For a fuller discussion of whether ISL's operations are sufficiently subjected to state oversight, we refer you to the enclosed expert report.

We hope our responses to these questions are helpful to you.

ATTACHMENT 2

**Analysis and Evaluation of
Iowa Student Loan Practices**

Mark Kantrowitz

*Nationally Recognized Expert on
Student Financial Aid and Education Loans*

September 19, 2008

President
MK Consulting, Inc.
PO Box 2056
Cranberry Twp, PA 16066
724-538-4500
724-538-4502 fax

Analysis and Evaluation of Iowa Student Loan Practices by Mark Kantrowitz¹

Table of Contents

Introduction.....	1
Executive Summary	2
Iowa Student Loan's Mission.....	6
ISL Private Loan Underwriting Criteria.....	6
ISL Private Loan Terms.....	12
Comparison of ISL Loans with Other Private Student Loans	14
Comparison of ISL Loans with FFEL PLUS and Stafford Loans	18
Selective Comparisons Presented in Marketing Materials for Federal Loans	22
Reimbursement Program and Payments to College Officials	25
ISL Employee Bonuses Based on Number of Borrowers and Loan Volume.....	28
ISL Executive Compensation Not Excessive.....	35
Above-Average Borrowing.....	35
Recommendations.....	36
Appendix A – About the Author.....	40
Appendix B – ISL's Mission.....	42
Appendix C – ISL Marketing Materials.....	46

List of Tables and Charts

Table 1: Comparison of ISL Private Student Loan Underwriting Criteria with PLUS Loan Criteria	7
Table 2: Comparison of ISL Private Student Loan Terms with the PLUS Loan.....	12
Table 3: Credit-Worthy Private Student Loans Offered by Other State Loan Agencies	17
Table 4: Comparison of ISL Credit-Worthy Loans with the FFEL PLUS Loan	19
Table 5: Comparison of ISL Credit-Ready Loans with the FFEL PLUS Loan	20
Table 6: Comparison of Executive Compensation for Non-Profit Education Lenders.....	35
Charts 1 and 2: Percentage of Loan Volume (ISL vs. National) for Private and PLUS Loans	36

Introduction

This report reviews Iowa Student Loan's practices in implementing its stated mission and the needs of Iowa students from 1997 to the present. It is based on information and documents provided by Iowa Student Loan Liquidity Corporation ("Iowa Student Loan" or "ISL"), some of which contain non-public information, current and archived copies of the ISL web sites, and publicly available information.

The Iowa Department of Justice engaged Mark Kantrowitz to provide expert analysis and evaluation of the current and past financial products and lending practices of ISL in connection with their review of ISL. Mark Kantrowitz is providing his services on a *pro bono* basis.²

¹ The author's biography may be found in Appendix A.

² This report represents the expert professional opinion of the author. It does not necessarily represent the opinion or policy of the author's employer or of the FinAid or FastWeb web sites.

Executive Summary³

This report reviews Iowa Student Loan's practices in implementing its mission of increasing access to and the affordability of loan options for Iowa borrowers. The evidence documented in this report demonstrates that ISL sacrificed affordability for some borrowers in exchange for improvements in access to loans by other borrowers, accommodating family preferences and providing borrowers with more choices in loan products. These practices increased costs for some borrowers by shifting borrowing from lower-cost PLUS loans to more expensive private student loans.

While increasing access and choice are worthwhile public policy objectives, some ISL marketing practices inappropriately and inaccurately presented or suggested that the ISL private student loans were the lowest cost options available to Iowa borrowers. Other ISL marketing practices were inconsistent with the goal of enabling borrowers to make an informed choice among the various borrowing options. ISL also mischaracterized potential reductions in monthly payments as "savings" without adequately disclosing the increase in total interest paid over the lifetime of the loan.

ISL loans are not underwritten using credit scores. This presents both advantages and disadvantages to Iowa students. This may have increased the availability of private student loans by extending credit to borrowers who might not otherwise have qualified for private student loans. For example, the ISL credit-ready loans did not require a cosigner or income criteria unlike the credit-worthy loans offered by ISL and other education lenders, and may also have been available to borrowers with thin or nonexistent credit histories. However, this loan increased availability when compared with federal loans only if the student was independent (and so ineligible for the federal PLUS loan) or if the student was dependent and his or her parents were unwilling or unable to borrow from the federal PLUS loan program.

The ISL private student loans also had the advantage of providing up-front pricing and greater transparency in the eligibility criteria. However, since the ISL loans were not priced according to credit quality, some borrowers with excellent credit would have been able to obtain lower cost loans with other lenders. The inclusion of these borrowers in the student loan portfolio enabled ISL to improve access to loans for other borrowers.

While the ISL private loans may have been competitive with other private loans, they were not the least expensive loans. ISL benchmarked its private loan products by comparing them with the loan products of seven large for-profit lenders after omitting the lowest cost credit tier. These lenders do not necessarily offer the lowest cost private student loans. Even so, an estimated 5% of ISL's credit-worthy borrowers and perhaps about a third of ISL's credit-ready borrowers (assuming that they had a credit-worthy borrower available) would have been able to get better rates with a for-profit competitor. Comparing ISL's private student loans with the private student loans offered by other non-profit state loan agencies finds that most other states offer less expensive loans to

³ For substantiation of claims made in the executive summary, please review the body of this report.

their state residents. In effect, ISL was subsidizing the credit-ready loan with income from the credit-worthy loans, trading off affordability for access.

This practice became problematic when the ISL loans were promoted as the lowest cost loans or as lower in cost than federal education loans or when ISL failed to promote lower cost federal loans first. While ISL loans were the lowest cost loans for *some* borrowers, they were not the lowest cost loan for *all* borrowers. Marketing the loans using superlative language as though they were the lowest cost loans was therefore inappropriate, as this would not necessarily have been in the best financial interests of all ISL borrowers. When making recommendations to a borrower, one must make a recommendation that considers only that borrower's best interests and not the best interests of borrowers in general.

In particular, it would not have been appropriate to recommend the ISL credit-ready loans or the ISL fixed-rate credit-worthy loans over the federal PLUS loan to a borrower who was eligible for the PLUS loan.⁴ While the ISL variable-rate credit-worthy loans may have offered better rates than the ISL PLUS loans to some borrowers, the costs were close enough that it would have been difficult to make such a recommendation with any degree of certainty. Also, some of ISL's competitors offered discounted rates on their PLUS loans that were clearly superior to ISL's private student loans. Consolidation loans could be used to lock in low rates on the PLUS loan, resulting in lower long-term costs on the federal loans. Finally, the most credit-worthy of ISL's private student loan borrowers would have been better off borrowing from one of ISL's competitors.

The marketing materials ISL used to promote its federal loans were also problematic because they provided an incomplete, unrealistic and one-sided characterization of the value of ISL's discounts and the benefits of extended repayment. These marketing materials used the longest available loan term to emphasize the dollar amount of the ISL borrower benefits (discounts) and the reductions in monthly payments without adequately disclosing the increase in total interest paid over the life of the loan. The calculations also assumed that the borrower would obtain the maximum possible discount without disclosing that most borrowers would not obtain this discount. The brochures also presented selective comparisons involving "savings per \$10,000 borrowed" without disclosing all the associated costs. For example, a 30-year loan term was used to increase the dollar amount of the savings from the borrower benefits without disclosing the increase in the total interest paid as compared with a 10-year loan.

⁴ Likewise, it would not have been appropriate to recommend the ISL private student loans over the federal Stafford loan to a borrower who was eligible for the Stafford loan. While ISL does not appear to have marketed the ISL private student loans as an alternative to the federal Stafford loans, some borrowers may have obtained partnership loans instead of Stafford loans because of a lack of clear guidance to borrow federal first in the marketing materials for the partnership loans. Starting with the 2007 partnership loan application, ISL has included the statement "Iowa Student Loan encourages students and parents to work with financial aid professionals at their respective colleges and universities to explore and exhaust other sources of federal, state and/or institutional financial aid, whether grant or loan, prior to obtaining a private loan." The 2007 partnership loan brochures, however, did not include a similar statement, nor specific advice to consider federal Stafford and PLUS loans before using the ISL private loans.

Other questionable ISL practices over the past decade include:

- Paying colleges based on the number of borrowers (with a 30 basis point volume-based cap). These payments were not disclosed at the time to prospective borrowers. While these payments were characterized as reimbursements for college expenses incurred in administering the ISL private student loan program, the payments may have had the effect of influencing colleges to steer more students to ISL loans. In fact, the average reimbursement per college increased significantly every year except the last partial year.⁵
- ISL bases employee performance adjustments in part on the number of borrowers. It is especially problematic to be basing College Planning Center ("CPC") and Iowa College Access Network ("ICAN") employee compensation in any way upon ISL performance given the goal of maintaining ICAN and the CPC as a source of neutral and objective information for families.⁶

Key recommendations include requiring additional disclosures to prospective borrowers, changes in ISL lending practices, improvements in ISL oversight and management, and elimination of conflicts of interest inherent in ISL compensation practices. Some of these recommendations have already been incorporated into the new statute enacted by the Iowa legislature (HF 2690, May 5, 2008) and the Higher Education Opportunity Act of 2008 (P.L. 110-315, August 14, 2008) enacted by Congress.

Disclosures:

1. ISL should include a disclosure statement in its marketing materials and web site that the Stafford loan is less expensive than ISL's private student loan products.⁷
2. ISL should remove all language that states or suggests that it provides the lowest cost student loans (or other superlative expressions) and instead may state that it provides low cost loans or lower cost loans or competitive loans.
3. ISL should be required to include total life-of-loan interest payment figures (or total payments) in any marketing materials that discuss reductions in the monthly payments. These figures should be displayed in a clear and conspicuous manner in close proximity to and in the same dominant typeface and point size as the reductions in monthly payments. In addition, ISL should be precluded from characterizing a reduction in the monthly payment as saving money when it involves an increase in the total payments.
4. Any marketing materials that refer to the maximum amount obtainable under ISL's loan discount programs should be required to disclose an estimate of the percentage of ISL's borrowers who will likely obtain the full discount.

⁵ ISL terminated the reimbursement program in 2007.

⁶ ISL has subsequently corrected this problem in the CPC incentive plan.

⁷ In particular, all brochures for ISL's private loans should include a statement encouraging families to consider borrowing from federal loans such as the Stafford and PLUS loans before borrowing from private loan programs.

5. ISL should be required to tell borrowers that they are not required to borrow from ISL's federal and private loan programs and may obtain their education loans from any lender.
6. ISL has improved the disclosures on its web site since the onset of the Attorney General's investigation. These improvements should be made mandatory.
7. The fine print disclosures on marketing materials should be required to be printed in at least a minimum type size to enhance readability.

Lending Practices:

8. ISL should require borrowers to have exhausted their subsidized and unsubsidized Stafford loan eligibility before becoming eligible for ISL's private student loans.⁸ For example, dependent undergraduate juniors and seniors are eligible to borrow up to \$7,500 in Stafford loans for the 2008-09 academic year and independent undergraduate juniors and seniors are eligible to borrow up to \$12,500. An undergraduate junior or senior who is eligible for the Stafford loan should not be permitted to borrow from ISL's private student loan program until he or she has borrowed these maximum amounts, as federal loans are cheaper, more available and have better repayment terms than private student loans.

Oversight and Management:

9. ISL should expand its benchmarking to include the loan programs offered by other nonprofit state loan agencies.
10. Individuals who serve on ISL's board to represent the interests of the state should not be paid for this service by ISL, as that would represent a conflict of interest.
11. It might be worthwhile to separate the advisory and oversight functions of the ISL board or to institute independent monitoring. Making ISL subject to open records laws might provide an opportunity for such monitoring by news media.

Employee Compensation:

12. ICAN and CPC compensation should not be dependent in any way on the number of ISL's loan applications, borrowers or funded loans, nor on any ISL-specific performance measures.

⁸ A memo dated December 16, 2007 states that "Students must take all of the guaranteed student loans for which they are eligible before accessing the Partnership Loan" so this recommendation may already be in use by ISL.

Iowa Student Loan's Mission

Iowa Student Loan (ISL) is a non-profit 501(c)(3) organization established as a secondary market for federal student loans in Iowa. ISL's articles of incorporation permit it to operate "supplemental student loan programs" that are "consistent with its charitable and educational purposes". ISL began offering a private student loan program, the Partnership Loan Program, in 1995. This program offers private student loans to both credit-worthy and credit-ready borrowers.

ISL represents its mission and goals, as documented in Appendix B, as encompassing two primary objectives:

1. *Access*. Increasing access to loans by providing loans to borrowers who otherwise wouldn't qualify for loans from other lenders.
2. *Affordability*. Providing the lowest cost federal and private education loans to each Iowa borrower.

In practice ISL also appears to maintain a third objective:

3. *Choice*. Accommodating family preferences regarding the terms of loan products.

ISL also includes statements on its web site that represent its mission as "help[ing] students and parents obtain the financial resources needed to fund postsecondary education".

Prioritizing these objectives within the constraints established by the Iowa state legislature is the responsibility of the ISL board of directors. However, there should be clearer and more specific disclosures of what this prioritization means for prospective borrowers.

It is worth noting that only access and affordability are officially part of the ISL mission, not choice. Increasing access is the only objective specified in the section of the Iowa Code that authorized the Partnership Loan Program.⁹ Affordability can be inferred from the ISL articles of incorporation, which require ISL programs to be "consistent with its charitable and educational purposes."

ISL Private Loan Underwriting Criteria

ISL's Partnership Loan Program has two main sets of underwriting criteria:

- Credit-worthy: The Cosigner- or Borrower-Income Contingent Options
- Credit-ready: No-Cosigner Options

⁹ Iowa Code section 261.38(5): "The commission may enter into agreements with the Iowa student loan liquidity corporation in order to increase access for students to education loan programs that the commission determines meet the education needs of Iowa residents."

ISL does not use credit scores (e.g., FICO scores) in underwriting its loans. Most other lenders use credit scores for both underwriting and pricing their loans, and also include credit score distribution data in the prospectuses for their asset-backed student loan securitizations. The transparency of ISL's underwriting criteria allows for up-front pricing of its loans, a significant benefit to borrowers.¹⁰ However, it also means that borrowers with excellent credit would have been able to obtain better rates from lenders with more precise credit-based pricing models.¹¹ The inclusion of these borrowers within ISL's student loan portfolio enabled ISL to improve access to loans for other borrowers.

Table 1 illustrates the underwriting criteria currently used by ISL and compares those criteria with the adverse credit history¹² criteria used in the PLUS loan program. It demonstrates that the ISL private loans are slightly more restrictive than the PLUS loan program.¹³ This means that all parent cosigners of ISL loans would have also qualified for the Parent PLUS loan and that all graduate and professional student borrowers of ISL loans would have also qualified for the Grad PLUS loan starting July 1, 2006. It is unknown whether undergraduate borrowers of the ISL loans who did not need a credit-worthy cosigner would have had parents who could have qualified for the Parent PLUS loan.

Table 1: Comparison of ISL Private Student Loan Underwriting Criteria with PLUS Loan Criteria

	ISL Credit-Worthy	ISL Credit-Ready	PLUS Loans
Delinquencies	<u>At most two 30-day delinquencies and no 60-day delinquencies in the previous two years.</u>	<u>At most two 30-day delinquencies and no 60-day delinquencies in the previous two years.</u>	<u>No current 90-day delinquencies on any debt.</u> ¹⁴
Write-offs	No bankruptcies, charge-offs, repossessions, collection accounts, judgments, foreclosures or wage garnishments by credit providers. <u>No defaults on any student loan.</u> No other derogatory credit notations.	No bankruptcies, charge-offs, repossessions, collection accounts, judgments, foreclosures or wage garnishments by credit providers. <u>No defaults on any student loan.</u> No other derogatory credit notations.	No bankruptcy discharges, repossessions, foreclosures, wage garnishments, tax liens, or defaults <u>in the past five years.</u> <u>No write-offs of federal education debt</u> in the past five years.
Income	Two years employment with annual income > \$15,000 (2 year requirement waived for retired and disabled persons)	N/A	N/A

¹⁰ Up-front pricing means that ISL borrowers do not have to apply for its loans in order to comparison shop. This avoids up to a 5-point hit to the prospective borrower's credit score.

¹¹ It is unclear why these borrowers did not obtain less expensive loans from ISL's competitors.

¹² Defined in 34 CFR 682.201(c)(2)(ii).

¹³ The Stafford loan program does not use any kind of credit underwriting criteria and so is more inclusive than both the ISL loans and the PLUS loan program.

¹⁴ The Ensuring Continued Access to Student Loans Act of 2008 (P.L. 110-227), signed into law on May 7, 2008, allows lenders to determine that extenuating circumstances exist if the borrower was 180 or fewer days delinquent for mortgage loan payments and medical bill payments and less than 90 days delinquent on other debts in calendar years 2007, 2008 and 2009.

Debt to Income Ratios	The ratio of monthly debt payments to gross monthly income is less than 40% for borrowers with mortgages and less than 25% for borrowers without mortgages.	N/A	N/A
Cosigner Required ¹⁵	No. But if the borrower is ineligible because of a failure to meet income or credit criteria, the borrower may become eligible by using a qualified cosigner.	No.	No. But if the borrower has an adverse credit history and accordingly is ineligible for the PLUS loan, the borrower may become eligible by obtaining an endorser who does not have an adverse credit history, as specified in 34 CFR 682.201(b)(4) and 34 CFR 682.201(e)(2).
Borrower	Student and possibly Parent cosigner.	Student.	Parent of dependent undergraduate student. Graduate or Professional Student since 7/1/2006.

Sources: Pages 4-5 and 11 of ISL letter from Craig Hurtt dated March 25, 2008 to Eric J. Tabor, Chief of Staff, Iowa Attorney General's Office; studentloan.org web site as of March 16, 2008; 34 CFR 682.201 sections (c) and (e) as cited.

The definition of an "adverse credit history" in 34 CFR 682.201(c)(2)(ii) is as follows:

Unless the lender determines that extenuating circumstances existed, the lender must consider each applicant to have an adverse credit history based on the credit report if –

- (A) The applicant is considered 90 or more days delinquent on the repayment of a debt; or
- (B) The applicant has been the subject of a default determination, bankruptcy discharge, foreclosure, repossession, tax lien, wage garnishment, or write-off of a Title IV debt, during the five years preceding the date of the credit report.

As is evident from this language, the five year lookback only applies to defaults, discharges, foreclosures, repossessions, tax liens, garnishments and write-offs. It does not apply to delinquencies. Only current delinquencies of 90 or more days apply.¹⁶

¹⁵ One of the ISL comparison charts used language that made the ISL Partnership loans seem superior with regard to Co-Borrower/Cosigner requirements. It used the language "Optional" for the ISL loans but "Endorser Required" for the PLUS loan. The footnotes for the former are (5) "Borrower must use a qualified cosigner only if the borrower does not meet credit or employment criteria" and for the latter (14) "Only if borrower has adverse credit. Decision to require an endorser is at the discretion of the lender."

¹⁶ In addition, the regulations at 34 CFR 682.201(c)(2)(iv) indicate that a thin credit history is not considered an adverse credit history: "The absence of any credit history is not an indication that the applicant has an adverse credit history and is not to be used as a reason to deny a PLUS loan to that applicant."

ISL's 30 or 60 day delinquency standard is harsher than a 90-day delinquency. Likewise, a 2-year lookback on delinquencies is harsher than a review of just current delinquencies.

As noted above, federal regulations require lenders to deny a PLUS loan to a borrower with a *current* delinquency of 90 or more days on any debt. Prospective ISL PLUS loan borrowers, however, appear to have been subjected to a *five-year lookback* on the 90-day delinquencies.¹⁷ This is a more stringent standard than imposed by other lenders and guarantee agencies. The five-year lookback on 90-day delinquencies potentially explains why ISL has a very high PLUS loan denial rate as compared with other lenders and contributes to the apparent shifting from PLUS loan volume to private loan volume.

ISL and ICSAC, ISL's guarantee agency, each disclaim responsibility for the more stringent adverse credit history criteria. In its August 4, 2008 response to a draft of this report ISL wrote "Note: the five-year look back period on PLUS delinquency was imposed on ISL by its primary guarantor, ICSAC, which provided the PLUS credit checks for all ISL lenders." A September 12, 2008 memo from Karen Misjak of ICSAC to Eric J. Tabor, Chief of Staff of the Iowa Attorney General's Office, states that ICSAC's PLUS loan denial policy "has not been more stringent than federal regulations." A copy of a 8/23/04 PLUS Credit Services Agreement with ICSAC's contractor, for example, defines "Adverse Credit History" as meaning "that one or more accounts in the credit history of an Applicant reflects (1) the Applicant is presently ninety (90) or more days delinquent on any account, loan or credit, or ..." While this may have been ICSAC's policy, in practice ICSAC's contractor appears to have implemented a much more stringent set of criteria. ISL supplied a set of 51 credit reports from the contractor each giving a PLUS loan denial reason of "90 DAYS DELINQUENT". None of these credit reports demonstrated a current 90-day delinquency. For 16 of the credit reports the 90-day delinquency appears to have been the only reason for denial of the PLUS loan. The credit reports were distributed across four time periods: before 12/8/03,¹⁸ 12/8/03 to 8/23/04, 8/23/04 to 6/9/06, and after 6/9/06. Five of the ten credit reports in the first time period appear to have used a lookback period longer than 2 years.¹⁹ All of the credit reports in the three time periods from 12/8/03 onward appear to have used a 2-year lookback. In the first and last time periods ICSAC had sole oversight over the contractor. In the other two time periods ICSAC and ISL had joint oversight over the contractor through a Chapter 28E agreement that was "jointly administered by ICSAC and ISL through the establishment and oversight of the budget and the evaluation of the quality of services performed by the vendor contracting with ISL as a guarantor servicing provider." One of the credit reports appears to have overlooked an example of repossession in its denial reasons, suggesting that there were also other quality control problems with the contractor. ISL and ICSAC need to work better together to ensure improved monitoring of the contractor.

¹⁷ While this 5-year lookback may stem from a misinterpretation of the regulations at 34 CFR 682.201(c)(2)(ii), the regulations at 34 CFR 682.201(c)(2)(iii) permit lenders to establish "more restrictive credit standards to determine whether the applicant has an adverse credit history".

¹⁸ The earliest report date with just a 90-day delinquency denial was 4/17/02.

¹⁹ In two of the credit reports, both with a 90-day delinquency as the sole denial reason, the 90-day delinquency occurred 4 years and 7 months before the date of the report.

When the ISL credit-ready loan is compared with the ISL credit-worthy loans and credit-based private student loans offered by ISL's competitors, it would appear to fulfill the access objective described above. Many of ISL's competitors use income and debt-to-income ratios that are similar to ISL's credit-worthy loans, along with credit scores. (Affordability will be discussed later.)

ISL's competitors generally do not make private student loans to credit-ready borrowers without a credit-worthy cosigner. It is unknown how many of these borrowers would have obtained a credit-worthy cosigner if the ISL credit-ready loans were unavailable. Some of the credit-ready borrowers may have preferred the higher-cost credit-ready loan because it did not require them to have a cosigner like the lower-cost credit-worthy loan.

However, the ISL credit-ready loan appears to have a similar risk profile to the PLUS loan except possibly for the number of years of lookback for delinquencies.²⁰ Accordingly, the ISL credit-ready loan only fulfills the access objective to the extent that it provides loans to undergraduate students whose parents are ineligible for the PLUS loan or graduate and professional students who are ineligible for the PLUS loan.²¹ Students who are eligible for the ISL credit-ready loan and may thereby have obtained increased access include:

- Independent students (student may not receive Parent PLUS loan funds)²²
- Students who failed to maintain satisfactory academic progress such as a minimum 2.0 GPA (student may not receive federal loan funds)²³

²⁰ While some parent borrowers of ISL credit-worthy private loans may have been ineligible for the ISL PLUS loan, this does not necessarily mean that ISL increased access, given that the ISL PLUS loan involved more restrictive eligibility criteria than other PLUS loan lenders.

²¹ While the ISL loans may provide education financing to borrowers whose parents are unwilling to borrow from the PLUS loan for various reasons (e.g., the inability to defer payments while the student is in school, the student not being obligated on the Parent PLUS loan, lower monthly payments due to a longer repayment term, refusal to file the FAFSA because of a recent divorce etc.), it is only when the parents are unable to borrow from the PLUS loan that one can make an access argument as opposed to a choice argument. A key component of modern need analysis philosophy is to distinguish factors that are beyond a family's control from those that are of a more discretionary nature. For example, guidance published by the US Department of Education on page AVG-24 of the 2008-09 Application and Verification Guide indicates that neither parental refusal to contribute to the student's education nor unwillingness to provide information on the FAFSA is sufficient to justify a dependency override. On the other hand, students who are estranged from their parents are often effectively denied access to a higher education until they satisfy the requirements in section 480(d) of the Higher Education Act of 1965 for independent student status. It is unclear the extent to which providing parents with the option of refusing to borrow on behalf of their students shifts borrowing away from the cheaper federal PLUS loans. Likewise, it is unclear the extent to which providing parents with the option of refusing to cosign their students' private student loans shifts borrowing away from less expensive cosigned private student loans. It nevertheless seems likely that the decision for some borrowers was more about choice than access.

²² Independent undergraduate students and dependent undergraduate students whose parents were denied a Parent PLUS loan become eligible for an additional \$4,000 per year of unsubsidized Stafford loan eligibility during the freshman and sophomore years, and an additional \$5,000 per year during the junior and senior years, with a \$23,000 additional aggregate limit (increased to \$34,500 additional starting July 1, 2008). Graduate and professional students who were denied a Grad PLUS loan do not receive increased unsubsidized Stafford loan limits. The extent to which the ISL credit-ready loans substituted for the increased unsubsidized Stafford loan limits is unknown.

- Dependent undergraduate students who themselves do not have an adverse credit history but whose parents were denied a Parent PLUS loan because of the parent's adverse credit history (student may not receive Parent PLUS loan funds)²⁴

Borrowers with an adverse credit history would not qualify for the ISL private student loans. ISL's private student loans provide increased access only to independent students who had borrowed the maximum Stafford loan limits or to credit-ready borrowers whose parents were denied a PLUS loan. Otherwise it would mainly appeal to borrowers who were unwilling (as opposed to unable) to borrow from the federal education loan programs or who preferred the private loans for some reason.²⁵

In addition, it is unknown to what extent credit-ready borrowers would have been able to obtain a credit-worthy cosigner in the absence of this borrowing option. Approximately 50% of Sallie Mae borrowers and 80% of First Marblehead borrowers have cosigners. In contrast, approximately 27% of ISL loans in 2006-07 involved a cosigner. However, it is not possible to evaluate the degree to which the ISL credit-ready loans shifted borrowing from lower-cost cosigned private student loans and so did not improve access.²⁶

The bottom line is that the ISL credit-ready loans certainly improved choice and may have improved access, but it is not possible to determine the degree to which ISL improved access because of a lack of objective data with which to evaluate the impact on access.²⁷ The basis for ISL's belief that it is improving access is unknown.

²³ ISL has indicated that it requires school certification and would not lend to borrowers who were not maintaining Satisfactory Academic Progress. ISL also indicated that it would make loans to borrowers who are ineligible for federal student aid because of a failure to file the Free Application for Federal Student Aid (FAFSA). The school certification process requests the school authorized loan amount, but does not otherwise detail the criteria for eligibility.

²⁴ As noted previously, ISL's PLUS loan eligibility used a more stringent 5-year lookback standard for delinquencies than other PLUS loan lenders who only consider current delinquencies. This more stringent standard was imposed by ISL's choice of guarantee agency and yielded a much higher PLUS loan denial rate. As a result, some of the increased access provided to students whose parents were denied a PLUS loan was a specious artefact of ISL's PLUS loan approval process.

²⁵ For the reasons why some borrowers prefer private loans over federal, see <http://www.finaid.org/loans/loantradeoffs.phtml>. Often families are persuaded by repayment examples showing a lower monthly payment (due to the longer repayment term of private student loans). Other reasons include confusion between private and federal loans, concern about privacy (especially in divorce cases), misconceptions about eligibility (some families do not realize that the unsubsidized Stafford loan and the PLUS loan are available without regard to financial need), the need for an in-school deferment (the Ensuring Continued Access to Student Loans Act of 2008 allows Parent PLUS loan borrowers to defer repayment until six months after the student graduates), and a preference for a loan that is a student obligation.

²⁶ Families do not always choose the lowest cost borrowing option, so some parents may have preferred a higher cost option because it did not require them to cosign the loans. For example, in 2007 approximately 50% of Sallie Mae private student loan borrowers did not have cosigners and 20% of First Marblehead borrowers even though having a cosigner usually results in a lower cost loan. Since then cosigner rates have increased significantly as lenders try to improve the quality of their private student loan portfolios.

²⁷ ISL maintains that it does not use credit scores in underwriting but has not directly answered the broader question whether they have ever received FICO scores for their borrowers. They do use credit history information in determining eligibility. If the credit history information included credit scores and they retained copies of the original credit reports, it might be possible to retrieve and consider the credit score information for a random sample of their borrowers in order to evaluate the degree to which the ISL credit-

ISL Private Loan Terms

Table 2 compares the terms of the current ISL private student loans with the PLUS loan.

Table 2: Comparison of ISL Private Student Loan Terms with the PLUS Loan

	Credit-worthy			Credit-ready		
	PLP I	PLP II 0%	PLP II 5%	Partnership II 0%	Partnership II 9%	PLUS
Annual Limit	COA-Aid	COA-Aid	COA-Aid	COA-Aid	COA-Aid	COA-Aid
Aggregate Limit	\$80,000	\$80,000	\$80,000	\$80,000	\$80,000	None
Term	20 years	20 years	20 years	20 years	20 years	10 years, may be extended up to 30 years
Deferments	Up to 7 years	Up to 7 years	Up to 7 years	Up to 7 years	Up to 7 years	Economic Hardship Deferment (3 years), Administrative Forbearances (3 years)
Interest Rate	8.4% (Fixed)	3-month LIBOR + 2.85% (Variable, Resets Quarterly)	3-month LIBOR + 2.20% (Variable, Resets Quarterly)	3-month LIBOR + 4.20% (Variable, Resets Quarterly)	3-month LIBOR + 2.70% (Variable, Resets Quarterly)	FFEL: 8.5% since 7/1/2006 (Fixed) DL: 7.9% since 7/1/2006 (Fixed) 91-day T-bill + 3.1% through 7/1/2006 (Variable, Resets Annually) ²⁸ Interest rate is maximum rate; lenders do offer discounts
Interest Rate Cap		21%	21%	21%	21%	9% ²⁹
Capitalization	Quarterly	Annually	Annually	Annually	Annually	No more frequently than quarterly. ³⁰ Most lenders capitalize annually or at status changes. ³¹

ready loan improved access. Since ISL does not maintain this information in its computer systems, retrieving the information would necessarily be laborious and time-consuming. An alternative could involve obtaining current credit scores for a statistically significant random sample of their borrowers. However, current credit scores would not necessarily be reflective of the credit quality of the borrowers at the time of loan application, since borrowers who graduate and obtain good jobs often experience an improvement in their credit scores. Yet, if one limited the sample to just the recent borrowers (e.g., those obtaining new loans in the last year) one could get a sense as to whether the loans are currently improving access. The lack of FICO score distribution data made evaluating the impact of ISL private student loans on access more difficult.

²⁸ The average spread between the 91-day T-bill and the 3-month LIBOR was 40 basis points from 1997 to 2006, meaning that the PLUS loan was roughly the equivalent of the 3-month LIBOR + 2.7%, not counting lender discounts.

²⁹ The 9% cap on the PLUS loan interest rate was in effect from 1994-95 to the present and was never reached while the PLUS loan had a variable interest rate. The lower 8.25% interest rate cap on consolidation loans means that consolidating an 8.5% FFELP PLUS loan in effect reduces the interest rate by 0.25%.

³⁰ Section 428B(d)(2)(B) of the Higher Education Act

³¹ For example, the Direct Loan program capitalizes interest on the PLUS loan at the end of the in-school and grace period, per example #24 at

www.studentaid.ed.gov/students/attachments/funding/PlusLoansQA.pdf

Fees	1%	0%	5%	0%	9%	4%
------	----	----	----	----	----	----

Sources: Comparison charts in July 26, 2007 ISL memo from Steve McCullough to Attorney General Miller; Higher Education Act of 1965 as amended.

ISL's loan discounts have included the following:

- On Consolidation loans, a 1.5% principal reduction based on the original loan balance after 5 months of on-time payments, a 1.5% principal reduction based on the current balance after 11 months of on-time payments (balance below \$18,500), and a 1.75% principal reduction based on the current balance after 11 months of on-time payments (balance above \$18,500). I estimate that these discounts are equivalent to 15 basis point, 11 basis point and 12 basis point interest rate reductions on a 20 year loan, respectively, assuming a 1 in 23 chance of missing a payment.³² On a 10 year term the equivalent interest rate reductions are 26 basis points, 18 basis points and 21 basis points, respectively. More recently ISL has offered a 0.75% prompt payment interest rate reduction with a six month delayed onset and a 0.25% interest rate reduction for auto-debit. This is the equivalent of a 19 bp rate reduction on a 10-year term and 14 bp rate reduction on a 20-year term.
- On PLUS loans, a discount of 8 months of free interest on their federal loans which they claim is the equivalent of a 70 basis point interest rate reduction.³³ Currently, a 0.60% interest rate reduction after 11 initial consecutive on-time payments for as long as the borrower continues to make on-time payments (once lost, not recoverable) and a payments (once lost, not recoverable) and 0.25% interest rate reduction for auto-debit. Assuming a 14% chance of signing up for auto-debit and the same chance of missing a payment, this is the equivalent of a 0.13% unconditional interest rate reduction from the start of repayment.
- On Stafford loans a waiver of the 1.5% origination fee and a 0.25% interest rate reduction for auto-debit, the equivalent of a 0.36% interest rate reduction.

These equivalent discount figures represent the average experience across a population of borrowers, as opposed to the unrealistic assumption that all borrowers obtain the full discount.

ISL's consolidation loan discounts have tended to provide a much shorter delayed onset for prompt payment benefits than was typical of for-profit lenders. This yields a greater

³² The 1 in 23 (4.37%) chance of missing a payment is derived from a February 20, 2007 open letter from Sallie Mae CEO Tim Fitzpatrick to student loan consumers which stated that "Only about 20 percent of borrowers who do not consolidate make their first 36 monthly payments on time. The bottom line is that less than 10% of borrowers will earn all the advertised Repayment Benefits as they will either consolidate their loans or miss a scheduled payment sometime during the first several years of repayment." The letter also noted that 70% of borrowers consolidate their loans in the first year of repayment. ISL consolidation loans have a lower chance of missing a payment, presumably due to a 5 day grace period instead of Sallie Mae's due date requirement. The lower probability of missing a payment yields equivalent interest rate reductions of 30 bp, 24 bp and 28 bp (10-year loan) and 17 bp, 14 bp and 17 bp (20-year loan).

³³ 0.70% would require a 6.5% chance of missing a payment, about 1 in 15. Actual ISL probability of missing a payment during the first 8 payments on the PLUS loan was about 6.7% in 2002 through 2007.

effective value for those discounts and increases the percentage of borrowers who qualify.

According to the ISL "Borrower Benefits Matrix – Deferments that Disqualify and Forbearances that Disqualify" (attachment #1 to the March 25, 2008 letter as part of the response to question #10 on page 16), borrowers could lose eligibility for these discounts if they are delinquent in repaying their loans or if they used one of several types of deferments and forbearances. For example, the disqualifying deferments include those for unemployment, economic hardship, disability, military service, Peace Corps, public health service, pregnancy and working in a teacher shortage area.

ISL does not use tiering to adjust the interest rates and fees to the risk of borrower default (other than at a very gross level with the split into credit-worthy and credit-ready loan products). Most of ISL's for-profit competitors use credit scores to assign borrowers to one of five or six credit tiers, with borrowers with better credit scores thereby obtaining lower interest rates and fees.³⁴

Comparison of ISL Loans with Other Private Student Loans

ISL supplied a comparison chart ("Comprehensive Current Comparisons of Loans") comparing their loans with the loans of seven unnamed competitors as of June 2005. ISL indicated that it periodically updates this chart and provides copies to its board of directors to help them evaluate ISL's loan programs.³⁵ This chart would seem to demonstrate that ISL's credit-worthy loans (but not ISL's credit-ready loans) were lower in cost than all the competitors except for Lender G. However, this did not provide the ISL board of directors with a realistic basis for evaluating ISL's loan programs.

³⁴ Borrowers with cosigners usually obtain a lower cost loan because lenders use the higher of the two credit scores both for eligibility and for the determination of the applicable interest rates and fees. Moreover, lenders seem to use a slightly better mapping from credit tiers to interest rates and fees when there is a cosigner, presumably because such loans are lower risk due to having two borrowers obligated on the loan instead of just one.

³⁵ The chart does not appear to have been provided to consumers or included directly in marketing materials. However, a version of this chart appears to have been intended for distribution to members of Congress.

The lenders are as follows:

- A. Wells Fargo
- B. US Bank
- C. Citibank Student Loans
- D. KeyBank
- E. Sallie Mae
- F. Bank of America
- G. Nelnet

The lenders were identified by the author by comparing the terms as listed in the ISL comparison chart with the published terms of all lenders offering private student loans. ISL will not attest to the accuracy of this information.

These are all large, for-profit lenders, not necessarily the lowest cost education lenders. ISL indicated that these lenders were selected because they were the ones most widely used in Iowa.³⁶ In addition, the interest rates are not the best available from these lenders in June 2005, when most had best rates of Prime – 1.0% or Prime – 0.5%. Another lender had a best rate of LIBOR + 1.0% but ISL listed only its top rate of LIBOR + 2.75%. ISL appears to have omitted the best credit tiers from the comparison charts for several of these lenders. Omitting the lowest cost tiers from the comparison charts is inconsistent with the stated goal (see Memo #6 and coversheet to the “Comprehensive Current Comparison of Loans” in Appendix B) of providing the charts to allow the ISL board of directors to verify that ISL offers “the lowest cost student loans available to Iowans”.

Based on interest rate distribution data in the prospectuses for the 2007 private student loan securitizations of Sallie Mae and First Marblehead, approximately 5% of ISL’s credit-worthy borrowers could have obtained lower cost loans from Sallie Mae and First Marblehead, and 28% to 34% of credit-ready borrowers would have been better off assuming that they could have obtained a credit-worthy cosigner. These figures were calculated by selecting the subset of the interest rate distribution with better rates and summing the corresponding percentages of loans or loan volume.³⁷

³⁶ As a nonprofit organization ISL should have been focused on comparisons based on program quality and benefits to borrowers, not market share.

³⁷ One can also estimate FICO score cutoffs by matching up the interest rate distributions and FICO score distributions included in the prospectuses (SEC Form 424B5) of the private student loan securitizations. One just calculates running totals for each distribution according to increasing interest rate and decreasing FICO score and pairs up any FICO score running total figures that are within a small percentage (say, less than 3%) of one of the interest rate running total figures. The matching pairs identify the likely FICO score cutoffs. When the last FICO score bucket has half the outstanding loan volume of the next bucket, it suggests that the cutoff is in the middle of the bucket. Using this method on the data on pages A-3 and A-10 of the prospectus for SLM Private Credit Student Loan Trust 2007-A yields estimated FICO score cutoffs of 635, 680, 720, 750 and 800. Similarly, using this method on the data on pages S-42 and S-45 of the prospectus for First Marblehead’s National Collegiate Student Loan Trust 2007-4 yields estimated FICO score cutoffs of 625, 650, 710, 740, 760 and 790. This simplified method isn’t perfect due to a linearity assumption in the mapping from FICO scores to interest rates. It does not account for potential changes over time in the lender’s interest rate formulas nor for variations in the mapping from FICO scores to interest rate formulas due to the presence or absence of a cosigner. But it should nevertheless be fairly close.

ISL's comparisons with large national lenders ignores smaller lenders that offer significantly lower cost private student loans, compensating for lower profits per loan with increased market share. For example, Education Finance Partners³⁸ offered interest rates of LIBOR + 1.8% to LIBOR + 6.0%, MyRichUncle offered interest rates of LIBOR + 2.25% to LIBOR + 8.0%, StudentLoans.com offered interest rates of LIBOR + 1.8% to LIBOR + 7.5% and Student Loan Xpress offered interest rates of LIBOR + 2.55% to LIBOR + 3.95%. ISL's comparisons also overlooked other large competitive lenders such as Access Group (LIBOR + 2.75% to LIBOR + 6.45%) and First Marblehead (LIBOR + 2.8% to LIBOR + 5.45%).

ISL based its claims of lower cost in part by limiting its comparisons to the average rates on competitor loans. But when one is making a recommendation of a loan to a borrower, one must consider that individual borrower's best interests and not just the best interests of borrowers "in general" or "on average". It is reasonable to conclude that borrowers with excellent credit (FICO scores 790 and up) would have obtained a less expensive loan by borrowing from one of these competitors.

ISL's benchmarking was also incomplete and inadequate (and not "comprehensive" despite the chart's title) because they did not compare their loan programs with private student loans offered by other non-profit state loan agencies. While these loans are not available to Iowa students, just as ISL's loans are not available to students from other states,³⁹ it would allow for an evaluation of how ISL's efforts stand in comparison with similar efforts in other states.⁴⁰

Table 3 provides examples of credit-worthy private student loans offered by other states for the 2007-08 academic year as of March 15, 2008. ISL's loans do not compare favorably with most of these loans, charging as much as 1% more in interest. Since most of these lenders do not offer loans to credit-ready borrowers without a cosigner, in effect ISL is subsidizing the credit-ready loan with income from the credit-worthy loans. This represents a tradeoff of affordability for access.

³⁸ Education Finance Partners entered into a \$2.5 million settlement with the New York Attorney General on April 16, 2007 in connection with allegedly inadequate disclosure of revenue sharing agreements of 25 to 100 basis points with colleges. CIT Group, the parent company of Student Loan Xpress, also entered into a \$3 million settlement with the New York Attorney General on May 10, 2007. Such settlements are insufficient basis for excluding a lender from the discussion of which lenders provided the lowest cost loans. Note that lenders C, E and G of ISL's own comparison charts entered into settlements of \$2 million each with the New York Attorney General, and one also entered into a \$1 million settlement with another state attorney general.

³⁹ ISL loans are available to Iowa students and Iowa residents. Other state loans have similar restrictions. So it is possible that out-of-state residents studying in Iowa and Iowa students studying out-of-state would have been eligible for both loans. The overlap is probably minimal.

⁴⁰ Such a comparison should also consider differences in the funding of each state loan agency, including differences in the amount of tax exempt bonding, as this may affect the cost to borrowers of each agency's loan products.

Table 3: Credit-Worthy Private Student Loans Offered by Other State Loan Agencies

Lender	Interest Rate	Fees	Term	Features
CollegeInvest (Colorado)	Variable interest rate of LIBOR + 2.3% (FICO 770 or higher), LIBOR + 2.75% (FICO 740-769), LIBOR + 3.95% (FICO 690-739) and LIBOR + 6.45% (FICO 660-689).	No fees.	20 years	No annual or aggregate limits.
Connecticut Higher Education Supplemental Loan Authority (CHESLA)	Fixed rate of 6.99%.	3%	140 months plus in-school and grace periods.	The annual limit is COA-Aid. The aggregate limit is \$125,000. Minimum income of \$20,000 and debt-to-income ratio of 40%.
Iowa Student Loan (ISL)	Fixed rate of 8.4%. Variable rate of LIBOR + 2.85% capped at 21%. Variable rate of LIBOR + 2.20% capped at 21%. Variable rates reset quarterly.	1% 0% 5%	20 years	Interest capitalized quarterly. Minimum income of \$15,000.
Maine Education Loan Authority (MELA)	Variable rate based on the auction rate of MELA tax-exempt bonds plus 2.5% (6.25%), reset annually.	0% to 6% at repayment.	4-20 years	Discounts include 0.25% interest rate reduction for auto debit and 0.50% interest rate reduction after 48 initial, consecutive on-time payments. No aggregate limit. Debt-to-income ratio of 50%.
Massachusetts Educational Financing Authority (MEFA)	Variable rate of PRIME + 0%, capped at 12%. (Previously MEFA offered a fixed rate of LIBOR + 2.8% and a variable rate of LIBOR + 1.6% capped at 12%.)	3% with cosigner, 6% without.	20 years	Interest capitalizes at repayment. Minimum income of \$18,000.
Michigan Higher Education Student Loan Authority (MHESLA)	Fixed rate of 6.95%. Variable rate of LIBOR + 1.5%, resetting annually.	3.5%	25 years	The annual limit is COA-Aid. The aggregate limit is \$125,000. Debt-to-income ratio of 45%.
New Hampshire Higher Education Loan Corporation (NHHELCO)	Variable rate of LIBOR + 2.0% to LIBOR + 5.5% with a cosigner and 1.0% higher without a cosigner. (The Leaf Consolidation Loan offers interest rates of LIBOR + 1.0% to LIBOR + 3.0% with no fees and a 20 to 25 year term.)	0% to 6%	15-25 years	Discounts include 0.5% interest rate reduction for auto-debit and 5% principal reduction after the first 25 consecutive on-time payments. Annual limit of COA-Aid. Aggregate limit of \$225,000.
New Jersey Higher Education Student Assistance Authority (HESAA)	Fixed rate of 6.25% (6.35% for graduate and professional students). The interest rate is 0.30% higher if the borrower defers payments of principal and interest while they are in school. The interest rate increases by 0.75% five years into repayment.	2%	20 years (25 for graduate and professional students)	Discounts include a 0.5% interest rate reduction for auto-debit. Minimum income of at least the poverty line for a family of four (\$21,200).
Rhode Island Student Loan	Fixed rate of 6.49% with	Up to 4%	15 years	The annual loan limit is \$35,000

Authority (RISLA)	4% fees. Variable rate of PRIME - 1.0% with no fees to Prime + 2% with 4% fees.			and the aggregate limit is \$125,000. Discounts include a 0.25% interest rate reduction for auto- debit.
-------------------	---	--	--	--

Sources: FinAid.org private student loan comparison chart and lender web sites.

There is nothing wrong with trading off affordability for access, if that is the public policy objective and if all appropriate disclosures are made to prospective borrowers. In effect, this increases the costs to borrowers who can afford it in order to provide loans to those who otherwise wouldn't be able to obtain the loans. It also increases costs to borrowers with superior credit in order to reduce costs to borrowers with inferior credit. ISL's practices become problematic to the extent that it identifies its loans as the lowest cost loans⁴¹ or as lower in cost than the PLUS loan.

The incomplete and selective nature of the ISL comparison charts may also have lead ISL and its board of directors to believe that the ISL loans were the lowest cost loans when in fact they were not. Accurate data and analysis is essential to managing an enterprise like ISL.

But clearly, most Iowans are not eligible for private student loans from other nonprofit state loan agencies. So a key question is whether the ISL loans were lower cost than the PLUS loans for each of the last ten years.

Comparison of ISL Loans with FFEL PLUS and Stafford Loans

Table 4 compares the fee-adjusted interest rates on each of the ISL credit-worthy loans to the FFEL PLUS loan, indicating whether the loan was superior to or inferior to the FFEL PLUS loan that year on the basis of a comparison of current and historical fee-adjusted interest rates. This determines whether or not it would have been appropriate to recommend the ISL loan based solely on the borrower's best financial interests using information available at the time. It does not consider the ability of PLUS loan borrowers to lock in a low rate by consolidating the loan.⁴² It does not consider non-financial

⁴¹ For example, stating or implying that its loans are the lowest cost loans without indicating that borrowers with excellent credit or eligible for state loans from the nonprofit state loan agencies in other states might be able to obtain less expensive loans from other lenders. This problem could have been avoided if ISL had qualified the statements in its marketing materials and on its web site (see Appendices B and C for examples) with adjectives like "most". The statements in question were removed from the ISL web site in early March 2008 after ISL suspended its private student loan program because of the difficulty in obtaining liquidity from the capital markets.

⁴² A consolidation loan is a fixed rate loan with an interest rate based on the weighted average of the interest rates on the loans being consolidated, rounded up to the nearest 1/8th of a point. Since this substitutes a fixed rate for a variable rate, borrowers of variable-rate Stafford and PLUS loans have used consolidation loans to lock in the current rate on the variable-rate loans when it hit historic lows. Thus consolidation of PLUS loans would have further reduced the cost of the PLUS loans as compared with the ISL private loans. From 2001-02 through 2004-05 interest rates on federal loans hit successive lows, and in 2005-06 started increasing again. Borrowers who consolidated too early would still have achieved a historic low for when they consolidated, and those consolidation loan interest rates would still have been significantly superior to ISL's rates. (According to the public record, the author of the present report

factors, such as the variety of deferments and discharges available to PLUS loan borrowers. As the data shows, the variable rate credit-worthy loans were slightly superior⁴³ in all but a handful of years but the fixed rate loan was not.

Table 4: Comparison of ISL Credit-Worthy Loans with the FFEL PLUS Loan

Interest Rate	8.4% fixed	COFI + 2.85%	COFIV + 2.3%	COFIV + 2.95%	LIBOR + 2.20%	LIBOR + 2.85%
Fees	1%	5%	5%	0%	5%	0%
ISL Superior	1997-98, 1998-99, 2000-01, 2006-07, 2007-08	1997-98, 1998-99, 1999-00, 2000-01, 2001-02, 2002-03, 2006-07, 2007-08	2002-03, 2003-04, 2006-07, 2007-08 Slightly superior in 2002-03 through 2007-08	Superior from inception (2004-05) onward	Possibly in 2006-07 and 2007-08 (missing data)	Possibly in 2006-07 and 2007-08 (missing data)
PLUS Superior ⁴⁴	1999-00, 2001-02, 2002-03, 2003-04, 2004-05, 2005-06	2003-04, 2004-05, 2005-06	2004-05, 2005-06	Only in certain quarters (Q1-2005, Q2-2005, Q1-2006, Q2-2006)	2005-06	2005-06
Ratio	5/11	8/11	4/6	4/4	2/3	2/3
ISL 11-year Average Interest Superior	Inferior. -1.14%	Somewhat superior 0.67%	Slightly superior 0.14%	Somewhat superior 0.47%	Slightly superior 0.02%	Somewhat superior 0.54%
Appropriate to recommend loan instead of PLUS	No	Not starting in 2003-04, yes otherwise	Not in 2004-05 or 2005-06, yes otherwise	Yes	Not in 2005-06, yes otherwise	Not in 2005-06, yes otherwise

Source: Analysis of ISL historical interest rate data by Mark Kantrowitz.

Overall, the differences between the PLUS loans and the variable-rate ISL credit-worthy loans were small. The differences between the PLUS loans and the fixed-rate ISL credit-worthy loans, however, were much larger, as much as 3% or more from 2002 to 2005. It would clearly have been inappropriate to recommend the fixed-rate ISL credit-worthy loan to a borrower eligible for the PLUS loan.

predicted the changes in the interest rates on federal student loans with very good accuracy. The author also predicted when the interest rates hit bottom, and pressured the US Department of Education to acknowledge the validity of the early repayment status loophole in time to allow the maximum number of students to take advantage of the historically low interest rates. These borrowers are saving more than \$1 billion in interest over the life of their loans. While predicting the future in general is difficult, predicting changes in the interest rates on federal education loans on the annual July 1 reset date is possible because the interest rates are based on the last 91-day T-bill auction in May, and the 91-day T-bill tends to track the Federal Funds rate and is otherwise quite stable.)

⁴³ Slightly superior was defined based on less than a 25 basis point difference. Somewhat superior was defined based on a difference of 25 to 75 basis points. Anything over 75 basis points was defined as superior. Similar magnitudes were used to qualify the degree of inferiority.

⁴⁴ Note that the comparison is with the FFEL PLUS loan and not the DL PLUS loan. The DL PLUS loan has had an interest rate that is 60 basis points lower than the FFEL PLUS loan since the switch to fixed interest rates on July 1, 2006. A comparison with the DL PLUS loan would have moved 2006-07 and 2007-08 from the ISL Superior row into the PLUS Superior row.

Table 5 is similar to Table 4, but compares the fee-adjusted rates on the ISL credit-ready loans with the PLUS loan. It demonstrates that the credit-ready loans were consistently inferior to the PLUS loan.

Table 5: Comparison of ISL Credit-Ready Loans with the FFEL PLUS Loan

Interest Rate	COFI + 2.85%	COFIV + 2.6%	COFIV + 4.1%	LIBOR + 2.7%	LIBOR + 4.2%
Fees	9%	9%	0%	9%	0%
ISL Superior	1997-98, 1998-99, 2000-01, 2006-07	None	None	None	None
PLUS Superior	1999-2000, 2001-02, 2002-03, 2003-04, 2004-05, 2005-06, 2007-08	2002-03, 2003-04, 2004-05, 2005-06, 2006-07, 2007-08	2004-05, 2005-06, 2006-07, 2007-08	2006-07, 2007-08	2006-07, 2007-08
Ratio	4/11	0/6	0/4	0/2	0/2
ISL 11-year Average Interest Superior	Slightly inferior	Significantly inferior	Somewhat inferior	Significantly inferior	Somewhat inferior
Appropriate to recommend loan instead of PLUS	No	No	No	No	No

Source: Analysis of ISL historical interest rate data by Mark Kantrowitz.

Note that several small and mid-sized lenders offered significant discounts on the interest rate on the PLUS loan during the 2005-06 and 2006-07 academic years. MyRichUncle offered a 1.75% unconditional interest rate reduction on the PLUS loan to 6.75% with 4% fees.⁴⁵ National City Bank reduced the PLUS loan interest rate to 6.8% with 4% fees.⁴⁶ The ISL private loans were inferior to these discounted rates.

It is also worth noting that except in 1997-98 with the credit-worthy Partnership II loan (COFI + 2.85%, 5% fee), the ISL private student loans were uniformly inferior to the Stafford loan in-school interest rate. Except in 1997-98 through 2001-02 for the Partnership II (COFI + 2.85%, 5% fees) and in 1997-98 for the Partnership II (COFI + 2.85%, 9% fees), the ISL private student loans were uniformly inferior to the Stafford loan repayment interest rate. It would therefore not be appropriate to recommend the ISL private student loans instead of the Stafford loan.⁴⁷

This yields the following conclusions:

⁴⁵ MyRichUncle ended this discount because of the College Cost Reduction and Access Act of 2007, but retained a 1% unconditional interest rate reduction on the Stafford loan for the 2007-08 academic year.

⁴⁶ National City increased the interest rate to 7.65% for the 2007-08 academic year because of the College Cost Reduction and Access Act of 2007, cutting the value of the discount in half.

⁴⁷ ISL does not appear to have recommended the partnership loans instead of the Stafford loans, but ISL also did not encourage prospective borrowers to borrow federal first in the marketing materials for the partnership loans. ISL did, however, start including a recommendation to borrow federal first in the partnership loan application in 2007. The marketing materials for the partnership loans still do not include a recommendation to borrow federal first.

- It would not be in the borrower's best financial interests to borrow from the ISL private student loans instead of the Stafford loan if the borrower were eligible for the Stafford loan.
- It would not be in the borrower's best financial interests to borrow from the ISL credit-ready loans instead of the PLUS loan if the borrower (or the borrower's parents) were eligible for the PLUS loan.
- It would not be in the borrower's best financial interests to borrow from the ISL fixed rate credit-worthy loan instead of the PLUS loan if the borrower (or the borrower's parents) were eligible for the PLUS loan.
- It might be in the borrower's best financial interests to borrow from the ISL variable rate credit-worthy loan instead of the ISL PLUS loan, but the costs were close enough that it would have been difficult to make such a recommendation with any degree of certainty. Some of ISL's competitors offered discounted rates on their PLUS loans that were superior to ISL's private student loans. Consolidation loans could be used to lock in low rates on the PLUS loan, making the federal loans have lower long-term costs.
- The most credit-worthy of ISL's private student loan borrowers would have been better off borrowing from one of ISL's competitors.
- ISL sacrificed affordability for some borrowers in exchange for improvements in access by other borrowers, although it is unknown how many of their credit-ready borrowers would have been able to obtain a credit-worthy cosigner if the credit-ready product had not existed.

The problem is not so much with the affordability of the ISL loans, which were all low cost loans but rather with the claims that these loans were the lowest cost loans available to Iowans.⁴⁸

Page 9 of the March 25, 2008 letter from Craig Hurtt of ISL to Eric J. Tabor, Chief of Staff of the Iowa Attorney General's Office states:

ISL will concede that under certain circumstances a small number of borrowers who choose ISL loans may have had lower rate alternatives at another provider, but this was the decision of the borrower. It may have been made for reasons other than the interest rate, such as loan repayment options; ease and speed of application; or desire to work with a local servicer. The number of borrowers in this category is unquantifiable because the underwriting criteria used by lenders like Citibank is proprietary. Actual comparisons are not, therefore, readily available. ISL has never claimed that its loans were best for every individual in every circumstance.

As documented in Appendix B, ISL did make such a claim on its web site.

⁴⁸ The inaccurate nature of the claim that ISL loans were the lowest cost loans (as opposed to among the lowest cost loans) might have been caused by a failure to appreciate the distinction between considering the interests of borrowers in general and the interests of each individual borrower.

Page 14 of the same letter states:

ISL compares its terms and interest rates to those being offered by others to determine that its loans carry Annual Percentage Rates that are better for borrowers, relative to its underwriting criteria. For credit-worthy loans, ISL knows that some organizations offer better APRs, but at much stricter credit criteria, meaning that only the best credits qualify. For some competitors, it is impossible to determine what borrowers must do to qualify for the rate being offered, even by calling the provider and asking the relevant questions to obtain the information needed by a borrower. ISL believes that no one else is currently offering a private fixed rate loan as low as the 8.40% ISL rate to Iowans. It also appears that private loan competitors are offering rates that approximate the Prime Rate to their top tier most credit-worthy applicants. The average credit applicants are receiving rates that approximate the Prime Rate plus 2% to 3%. Meanwhile ISL is offering all borrowers that qualify for its Partnership Loan a rate that approximates the Prime Rate.

Selective Comparisons Presented in Marketing Materials for Federal Loans

ISL's marketing materials, as presented in attachment #2 to the March 25, 2008 letter and the accompanying CD-ROM, included assumptions that the borrower would qualify for the full discount.⁴⁹ This is not reflective of the typical experience of ISL borrowers based on the prompt payment percentages charts provided by ISL as Attachment #1 of the May 2, 2008 ISL letter to Eric J. Tabor, Chief of Staff, Iowa Attorney General's Office. For example, the "Great Reasons to Consolidate with Iowa Student Loan" brochure included a statement "Save over \$1,000 on every \$8,000" which is consistent with a 2.88% interest rate on a 20 year term with a 0.25% interest rate reduction for auto-debit and a 0.75% interest rate reduction for prompt payment after a 6 month delayed onset, but only if the borrower is not late with any of the first 6 payments. Based on the data presented in Attachment #1 of the May 2, 2008 ISL letter, [REDACTED] to [REDACTED] of ISL consolidation loan borrowers missed the first payment and [REDACTED] to [REDACTED] would achieve the 6-month threshold. The average savings per borrower is less than [REDACTED] to [REDACTED] per \$8,000 and a [REDACTED] to a [REDACTED] of ISL borrowers would obtain no discounts.

The brochure also emphasized the reduction in monthly payments from extended repayment without adequate disclosure of the impact on total payments over the life of the loan. There was some fine print, "Since you will be paying interest over a longer time period, consolidation of your loans may increase the total amount repaid", but no concrete figures. Many students are relatively inexperienced when it comes to managing money and do not appreciate abstract statements as much as concrete examples. For example, in the \$50,000 example the brochure shows a 52% reduction in the monthly payment but doesn't mention that the total payments over the life of the loan will increase by \$19,800.⁵⁰

⁴⁹ See Appendix C for examples.

⁵⁰ There is no requirement for a borrower who consolidates their loans to use extended repayment. In fact, section 428C(b)(9) of the Higher Education Act of 1965 specifies that the borrower should choose the

Another brochure compares the 4.125% interest rate one could have obtained by consolidating during the repayment period for 2002-03 with the maximum rate of 8.25%.

Clearly, there was a financial benefit to borrowers locking in historically low interest rates. In addition, extending the repayment term does reduce the size of the monthly payment. However, it does not save the borrower money as he or she will have to pay more total interest over the life of the loan, often negating the benefit of locking in a lower interest rate.

Another brochure entitled "Consolidate your Federal Student Loans today!" compared the standard ten-year repayment with the initial payment under the graduated repayment plan. The graduated repayment plan starts with lower monthly payments and steps them up every two years. For a \$60,000 loan this resulted in a comparison of \$700 with \$337 yielding a "monthly payment savings" of \$363. In reality the graduated payment example increased the loan term to 30 years, increasing the total interest from \$24,118 to \$74,752.

The "Consolidate your Federal Student Loans today!" brochure calculated the potential savings for a borrower who qualified for the full amount of the loan discount. It used the maximum repayment term for the loan amount to emphasize the amount one could save. For example, on a \$60,000 loan with 6.625% interest and a 30 year term, with no fees and a 1.25% prompt payment interest rate reduction after 12 months and 0.25% interest rate reduction for auto-debit, the discount is characterized as saving \$6,162 in interest on every \$10,000 borrowed. The brochure fails to disclose that using a 30 year term as opposed to a 10 year term will cost an additional \$9,349 in interest over the life of the loan per \$10,000 borrowed. (The potential savings from the discount on a 10-year loan is up to \$822 per \$10,000 borrowed. Despite the lower discount, the borrower saves more money by choosing a shorter loan term. While the borrower may choose a longer repayment term to obtain a lower monthly payment, it is inaccurate to characterize this as saving money.)

Similar issues also occur with ISL brochures that are focused on Stafford and PLUS loans instead of consolidation loans. For example, the 2004 "Planning and Funding YOUR College Education" brochure states "You Save \$350 on every \$5,000!" by assuming that the borrower qualifies for the maximum benefit, a 2.5% interest rate reduction with on-

repayment plan on a consolidation loan, and that if the borrower did not specify a repayment plan, the lender is required to provide a standard 10 year repayment plan. Borrowers can choose to remain with standard ten-year repayment. Lenders often encourage borrowers to choose the maximum repayment term through examples like this – which characterize the reduction in the monthly payment as "savings" or "more money in your pocket" – because the longer repayment term maximizes the lender's profits on the consolidation loan. Even without extending the repayment term there may be a slight reduction in the monthly payment. For example, a borrower with four loans of \$2,625, \$3,500, \$5,500 and \$5,500 at 6.8% and a 10-year term would have monthly payments totaling \$226.58 since the first two loans would be rounded up to the \$50 minimum payment. A consolidation loan with a 10-year term would yield a monthly payment of \$197.73, a 13% reduction, by eliminating this rounding. The total interest paid would increase from \$5,661.63 to \$6,603.34, a 17% increase. With extended repayment (a 15-year term) the monthly payment would drop from \$226.58 to \$152.73, a 33% reduction, but the total interest paid would increase from \$5,661.63 to \$10,366.42, an 83% increase.

time payments. While the footnotes do disclose that the 2.5% interest rate reduction is after 48 on-time payments and that the comparison is assuming that the borrower makes 48 on-time payments, the footnotes fail to disclose the savings received by typical borrowers. According to prompt payment statistics provided by ISL, less than [REDACTED] of borrowers in 2004 made the first 48 payments on time. The choice of a maximum reference rate of 8.25% also maximizes the amount of the discount. The actual average savings per borrower will be less than [REDACTED] per \$5,000 borrowed and [REDACTED] of ISL borrowers would obtain no discounts. Similar problems occur in the 2005 version of this brochure. The 2006 brochures added a footnote stating "The borrower must sustain on-time payments to retain the 2.50% interest rate reduction." This further reduces the average savings to less than [REDACTED] per \$5,000 borrowed and means that less than [REDACTED] of borrowers will obtain the full discount.⁵¹

The 1998 "Magnify Student Savings" brochure compares the savings on \$5,000 and \$15,000 loans with the ISL loan discounts. The footnote specifies the interest costs associated with the two loans as "The finance charge on the \$5,000 loan is \$1773 and the finance charge on the \$15,000 loan is \$5319." This footnote was omitted from the 1999 version of the same brochure.

These selective repayment examples are inconsistent with a goal of minimizing the cost of debt to ISL borrowers or helping ISL borrowers make informed borrowing decisions.

The 1998 Partnership Loan Program folder characterizes the loan as providing "Low, competitive interest rates: students pay less for education." The 2000 Parent Partnership Loan brochure characterizes the loan as providing "Competitive interest rates: Parents pay less interest." The 2003 Partnership Loan Program brochure changes the language to "Competitive interest rates: Partnership Loan interest rates are very competitive with rates charged by other education loan providers." The 1998 Partnership Loan Program brochure specifies in a list of benefits of the Partnership Loan that "The fixed rate Partnership I Loan or the variable rate Partnership II Loan are extremely competitive with the Federal PLUS loan and other alternative loan options."

Several ISL brochures include a chart titled "Historical Approximation of Interest Rates for the variable rate Partnership Loan" that limited the y axis scale in a manner that overemphasized decreases in interest rates. For example, the 2000 Parent Partnership brochure had a data range of 6.15% to 6.75%, instead of starting the range at 0.0%, which overemphasizes the drop in interest rates from 6.63% in March 1999 to 6.12% in June 1999. The 2005 and 2006 partnership loan program brochures have a data range of 3.20% to 6.80%. Not only does the range not start at 0.0%, but it has a significant excess range over the highest interest rate displayed (5.72%), crowding the graphs in the bottom half of the chart, suggesting that the interest rates are lower than they really are.

Note that the 2005, 2007 and 2008 versions of the "Explore Your Financing Options" brochure provide a "PLUS vs. Private Loan Chart" that highlights the benefits of the

⁵¹ These figures assume a [REDACTED] chance of missing a payment, which is consistent with [REDACTED] making the first 48 payments on time.

PLUS loan over private loans, a sharp contrast with the internal promotion to the ISL board of directors of the ISL private student loans as competitive with the PLUS loan.

While ISL did provide a separate comparison chart of the PLUS and private loans, it did not include a recommendation that borrowers consider federal loans first in the marketing materials for their private student loan programs. For example, there is no mention of federal Stafford and PLUS loans in the 2005, 2006 and 2007 versions of the Partnership Loan Program brochure, nor in the 2000 Parent Partnership brochure nor in the 2007 PLP/Parent combined brochure. The 1998 partnership loan brochure did mention the Stafford and PLUS loan discounts, but did not provide a comparison with the private loans or a recommendation to borrow federal first. Rather, it was included as part of a recommendation that students should consider Iowa Student Loan for all of their student loan needs. This was reduced to a listing of just the Stafford loan discounts in the 2003 Partnership Loan Program small brochure.

The two-page 2006 Partnership Facts You Need to Know brochure purports to discuss the differences between Partnership Loans and Stafford loans, but it is mainly a discussion of the Partnership Loan repayment terms with only two mentions of the Stafford loan. One mention concerns an inability to consolidate partnership loans with Stafford loans. The other is a statement that deferment options for the two loans differ, but it describes only the deferment options for the Partnership loan. The brochure does not discuss the advantages of the Stafford Loan, such as subsidized interest, a shorter repayment term, loan forgiveness options, or various discharges and deferment options.

Marketing materials that make claims about potential savings or interest rates discounts should be considered misleading when many borrowers do not realize those savings or obtain the advertised discounts. Fine-print disclaimers that actual performance may vary from the advertised claims are inadequate because student borrowers are especially vulnerable given their lack of experience, lack of financial literacy and greater tendency to impulsiveness. At minimum the marketing materials should include disclaimers that disclose information about typical or average performance or the realization rates for receipt of the full discount.⁵² Even so, such disclaimers are probably still inadequate because the remedy for the misleading claim is in a smaller typeface with less prominent placement and so will not share equal attention with the misleading claims. Disclaimers must also be included with the marketing materials on the same page as the misleading claim and not on a separate page or document. Teaching students about making wise borrowing choices should be up front, not after the fact.

Reimbursement Program and Payments to College Officials

According to documents provided by ISL, ISL maintained a program in which it made payments to as many as 50 colleges to reimburse the colleges for expenses incurred by

⁵² Publishing the percentage of borrowers who miss particular payments, such as the first payment, can help improve discount realization rates by highlighting potential pitfalls. Several lenders, including Sallie Mae, NorthStar Guarantee and Graduate Leverage, have published performance and realization rate data without any adverse effects on borrower repayment behavior.

the colleges in administering ISL's loan programs, such as counseling borrowers, certifying loan applications and disbursing loans, all functions that are normally considered part of a college's administrative capabilities. The reimbursements were based on the number of borrowers and the staff time spent per borrower⁵³ (plus postage and printing costs associated with promoting the Partnership Loan Program) and included a volume-based cap of 0.30%.⁵⁴ In effect, ISL was paying a fee for every loan application it received, roughly \$25 per loan application at private colleges and \$15 per loan application at community colleges. The fees ISL paid to the colleges were not disclosed at the time to prospective borrowers.

These payments provided the colleges with an incentive to increase the loan volume they sent to ISL, especially since ISL's competitors did not provide a similar inducement.⁵⁵ The average reimbursement⁵⁶ per college increased each year except the last, which was a partial year:

- FY03 \$4,194.65
- FY04 \$5,731.94 (37% increase)
- FY05 \$6,992.26 (22% increase)
- FY06 \$8,351.04 (19% increase)
- FY07 \$6,258.44

The reimbursements apparently increased each year because of an increase in the number of ISL borrowers at each school, suggesting that payment of the fees lead to increased utilization. ISL paid a total of \$1,513,223 to colleges during the five years the reimbursement program was in operation. ISL also made payments to the ISU alumni association and possibly other alumni associations for the marketing of its consolidation loans.

This reimbursement program may not have violated the prohibited inducement rules in the Higher Education Act of 1965⁵⁷ because the payments were made in connection with a private student loan program and not a federal education loan program. However, while

⁵³ Colleges were not required to substantiate the time spent per borrower.

⁵⁴ Colleges were aware of the 0.30% cap on reimbursements.

⁵⁵ Reimbursing colleges for administrative expenses is not a standard industry practice. ISL appears to have been the only lender to adopt such a practice. Other lenders paid schools a revenue share for their private student loan products (before being dissuaded from continuing the practice by the New York Attorney General), but none characterized it as a reimbursement.

⁵⁶ Calculated based on data provided by ISL as part of a March 10, 2008 letter to Eric J. Tabor, Chief of Staff, Iowa Attorney General's Office concerning the total reimbursement and the number of participating colleges during each fiscal year for which the program was in existence. ISL did not provide any per-college detail.

⁵⁷ Section 435(d)(5) of the Higher Education Act bans lenders that "offered, directly or indirectly, points, premiums, payments, or other inducements, to any educational institution or individual in order to secure applicants for loans under this part". Dear Colleague Letter DCL-95-G-278 (DCL-95-L-178) from the U.S. Department of Education states that the prohibited inducement rules "removes an economic interest that may affect the school's objectivity as it advises the student with respect to financial assistance", and that "students' borrowing decisions [be] made on the merits of the loans rather than on extraneous marketing incentives to students and their schools" and "such decisions should be based on the merits of the loans and not on extraneous factors, particularly not on monetary benefits given to the schools on which students often rely in such matters".

the reimbursement program may have been technically legal at the time,⁵⁸ it presented colleges with a potential conflict of interest between their pecuniary interests and the best interests of prospective borrowers.

The New York Attorney General obtained financial settlements totaling more than \$12 million with seven lenders⁵⁹ and nearly \$6 million with 16 colleges⁶⁰ for revenue-sharing agreements involving the payment of fees by the lenders to the colleges based on the number or volume of loans originated. The Nebraska Attorney General reached a financial settlement totaling \$1 million with one lender. Most of the settlements involved private student loans. The Connecticut, Florida, Maryland, Missouri and New Jersey attorneys general implemented codes of conduct that banned education lenders from making payments to colleges, among other prohibited activities. The New York state legislature enacted the Student Lending Accountability, Transparency and Enforcement (SLATE) Act of 2007 in May 2007 to encode aspects of the New York Attorney General's college and lender codes of conduct into law. Similar bans on revenue sharing were enacted by the Iowa state legislature on April 29, 2008 and signed into law by the governor on May 5, 2008.⁶¹

ISL wrote in a letter dated March 10, 2008 to Eric J. Tabor, Chief of Staff of the Iowa Attorney General's Office:

The Partnership Loan Program requires students to be counseled before borrowing. Such counseling requirement had the effect of creating work and costs for college financial aid officers. To help ease the administrative burden, ISL, over a five year period, offered to partially reimburse these costs. To receive the money, colleges had to submit receipts and other documentation of their costs directly incurred in administering the program, and then were reimbursed up to a preset limit. Many colleges did not reach the preset limit.

As stated above, Iowa Partnership Loans were created by state statute. If ISL had not offered to partially reimburse the schools for some of their administrative costs, the result would have been an unfunded mandate on colleges and universities that could have threatened an extremely valuable aid program. This ISL program was similar to the cost allowance that colleges received for administering various other federal aid programs.

Section 463(b) of the Higher Education Act provides for a payment in lieu of reimbursement of institutional expenses in administering the Perkins Loan program, referencing section 489. Section 489 allows the U.S. Department of education to provide

⁵⁸ The Iowa legislature subsequently banned this practice as part of HF 2690 (signed into law by the governor May 5, 2008 and effective July 1, 2008 and January 31, 2009). See <http://coolice.legis.state.ia.us/Cool-ICE/default.asp?Category=BillInfo&Service=Billbook&ga=82&hbill=HF2690>

⁵⁹ Range of \$60,000 to \$3 million.

⁶⁰ Range of \$2,435.41 to \$1,617,580.

⁶¹ See www.finaid.org/illegalinducements for additional detail concerning law enforcement and statutory and regulatory action.

a payment of \$5 per student receiving assistance from the Pell Grant program, and a decreasing escalator of reimbursements for certain levels of expenditures for administering the SEOG Grant, Federal Work-Study, and the Perkins Loan Program. These allowances were provided by the U.S. Department of Education to the schools and not by a lender.

The Higher Education Amendments of 1976 provided for a \$10 administrative allowance for every Guaranteed Student Loan (the predecessor of the Stafford Loan) processed by the school. This was never funded.

There are many federal programs for which there is no administrative cost allowance, such as the Academic Competitiveness Grants and the National SMART Grant. Unfunded mandates are quite common and colleges generally still offer the programs despite the lack of administrative funding because the programs are of benefit to their students.

So aside from the Perkins Loan program, the US Department of Education generally does not provide an administrative cost allowance for any loan program. Schools do not get any reimbursement for any costs associated with the Stafford and PLUS loans, not even for the entrance and exit counseling.

Moreover, the administrative cost allowances for federal aid programs were specifically authorized by statute. Although the Partnership Loan Program was created by state statute, there is no language in chapters 261 and 261A of the Iowa Code that specifically authorizes reimbursement of colleges for their costs in administering the Partnership Loan Program.

Note also that the language "could have threatened an extremely valuable aid program" suggests that colleges might not have participated in the Partnership Loan Program if not for the reimbursements.

ISL terminated the reimbursement program after it was criticized in the Des Moines Register on May 6, 2007.

ISL Employee Bonuses based on Number of Borrowers and Loan Volume

ISL stated on page 10 of the May 2, 2008 letter from Craig Hurtt of ISL to Eric J. Tabor, Chief of Staff of the Iowa Attorney General's Office:

At no time did staff performance adjustments relate to the generation of any specific loan product. ISL has never paid any employee bonus or incentive pay which would cause employees to promote any ISL product to the detriment of the borrower. ... As loan demand grew based on increasing college costs and other independent factors in Iowa, employees were rewarded for managing the workload -- not for creating the dollar volume. Management and the board have made conscious efforts to measure ISL success, in part, on

the number of borrowers served, and not the dollar volume of new loans originated. This rewards work performed in servicing existing borrowers as well as new borrowers.

This ISL statement is not consistent with the information ISL provided concerning its compensation practices, as described in the ISL Staff Performance Adjustment Summary in Attachment 2 to the same May 2, 2008 letter. Specifically, the attachment indicates that ISL pays bonuses in part based upon the number of borrowers. For example, number of borrowers had a 25% weight in the senior management program from 2000 to 2007. Owned and serviced volume had a 30% weight in 1999 and 25% weight in 1998. Number of borrowers had a 33.3% weight for non-senior management from 2001 to 2007. Providing employee compensation based in part on the number of borrowers or the owned and serviced volume gives employees an implicit and explicit incentive to increase the number of borrowers and the amount of volume.

Especially noteworthy is the fact that number of borrowers had a 5% weighting for College Planning Center ("CPC") and Iowa College Access Network ("ICAN") staff from 2003 to 2007 and a 10% weighting from 2001 to 2002. This incentive to increase the number of ISL borrowers is inconsistent with the goal of maintaining ICAN and CPC as objective and neutral resources for Iowa students. It presents a clear conflict of interest.

ISL's emphasis on the number of borrowers as opposed to the dollar volume, even if were an accurate characterization of their compensation practices, is irrelevant with regard to federal law and regulations. Basing compensation on either might potentially be construed as a violation of the federal rules concerning prohibited inducements. It is also in conflict with the goal of serving the best interests of Iowa borrowers, since it potentially encourages maximizing the number of borrowers and maximizing the average debt per borrower.

Federal law and regulations concerning prohibited inducements do not distinguish between dollar volume and number of borrowers. For example, the prohibited inducement language in section 435(d)(5) of the Higher Education Act of 1965 states:

DISQUALIFICATION FOR USE OF CERTAIN INCENTIVES. – The term "eligible lender" does not include any lender that the Secretary determines, after notice and opportunity for a hearing, has after the date of enactment of this paragraph –

A. offered, directly or indirectly, points, premiums, payments, or other inducements, to any educational institution or individual in order to secure applicants for loans under this part; ...

Likewise, the definition of "lender" in the regulations at 34 CFR 682.200(b) states:

The term "eligible lender" does not include any lender that the Secretary determines, after notice and opportunity for a hearing before a designated Department official, has –

- i. Offered, directly or indirectly, points, premiums, payments, or other inducements, to any school or other party to secure applicants for FFEL loans

...

The final regulations published in the Federal Register⁶² on November 1, 2007, which become effective July 1, 2008, amend this definition by adding "or to secure FFEL loan volume" at the end. The amended regulations also add a ban on

- (2) Payments or other benefits to a school, any school-affiliated organization or to any individual in exchange for FFEL loan applications, application referrals, or a specified volume or dollar amount of loans made, or placement on a school's list of recommended or suggested lenders.

...

- (5) Payment to another lender or any other party of referral fees or processing fees, except those processing fees necessary to comply with Federal or State law.

However, the US Department of Education's prior guidance, as published in Dear Colleague Letter 89-L-129 (February 1989) stated:

The Department believes these provisions were broadly intended to prohibit the direct or indirect offering or payment of any kind of financial incentive by a lender to any entity or person to secure applicants for Part B loans ... regardless of the form of the incentive or its mode of payment.

...

Examples of Prohibited Inducements:

...

- 4. A lender pays another lender a "referral" or "finder's fee" for loan applications referred to the paying lender, ostensibly to compensate the referring lender for administrative costs incurred in processing the applications and in advertising the availability of loans through the payee lender. The portion of the fee that exceeds reasonable compensation for the referring lender's processing of loan applications and advertising constitutes a prohibited inducement.
- 5. A lender pays a "processing" fee to another lender, but only if the applicant actually obtains a loan.

...

⁶² Federal Register 72(211):61960-62011, November 1, 2007.

8. A guarantee agency provides payments to a school or its affiliates to induce the school to participate in the agency's program or to increase the number of applications submitted to the agency.

This indicates that until the effective date of the new regulations, compensation for processing applications can be based on the number of applications but not on the number of actual borrowers, the number of funded loans or the loan volume.

The use of the word 'individual' in the current and previous regulations applies to both school employees and lender employees. The language in section 435(d)(5) of the Higher Education Act of 1965 is "to any educational institution or individual". The language in the regulations at 34 CFR 682.200(b) parallels the statute, using "to any school or other party". DCL 89-L-129 uses language "to any entity or person". In each of these cases the language uses general words like "individual", "party", "person" and in no way limits the type of individual to whom compensation is paid for securing loan applicants.

The following excerpt from pages 61978-61979 of Volume 72, Number 211 of the Federal Register as published on November 1, 2007, clarifies the US Department of Education's position on whether "individual" refers to just college employees or not. In particular,, page 61979 of the discussion of the regulations as published in the Federal Register states: "The Secretary has never interpreted the reference to 'individuals' as limited to employees of a school or a school-affiliated organization."

Payments to Individuals and Lender Referral and Processing Fees (§ 682.200(b))

Comment: Several loan industry commenters claimed that the preamble of the NPRM was incorrect in stating that "Compensation or fees based on the numbers of applications or the volume of loans made or disbursed are improper, regardless of label, under the Department's current and prior policy and would continue to be improper under these proposed regulations." The commenters stated that the Department had previously allowed lenders to pay marketing compensation based on the number of applications received, but not based on the number of applications that resulted in funded loans. The commenters asked that the Secretary clarify that this interpretation continues to apply until the effective date of the final regulations, and that any change in policy be applicable to activities occurring on or after July 1, 2008.

The commenters also requested that the reference in the regulation to prohibited payments to "any individual" in paragraph (5)(i)(A)(2) of the definition of lender in § 682.200(b) be removed and replaced with "any employee of a school or school-affiliated organization" to clarify the group to which the prohibitions apply. The commenters further requested that the reference to "processing" fees be removed in paragraph (5)(i)(A)(5) of the definition of lender in § 682.200(b) because use of this term could be interpreted as prohibiting longstanding commercial contractual relationships

with third-party servicers and other parties that provide anti-money laundering and PATRIOT Act screening, electronic signature processing, loan origination services, loan disbursement services, and escrow agent services to lenders and guaranty agencies.

The loan industry commenters also argued that the regulations would effectively prevent some small nonparticipating lenders from meeting their Community Reinvestment Act requirements through the student loan program.

Discussion: The commenters did not correctly describe the Department's prior policy guidance regarding application referral programs between lenders and marketing arrangements between lenders and other parties. The Department's policy on marketing and referral fees was specified in Dear Colleague Letter 89-L-129 (February 1989). The Dear Colleague Letter stated that any fee paid for loan applications under a lender referral program or marketing arrangement would be considered a prohibited inducement if the amount exceeded reasonable compensation for the referring lender's or party's processing of loan applications and advertising. Under this policy, the Department approved or did not object if the compensation paid was reasonable compensation for processing of loan applications and advertising. The permitted reasonable compensation could be based on applications referred but not on loans funded or disbursed. This policy statement remains in effect until the effective date of these regulations.

The Secretary disagrees that reference to "individuals" should be struck from paragraph (5)(i)(A)(2) of the definition of lender in § 682.200(b). Section 435(d)(5) of the HEA effectively defines an improper inducement as a payment or other inducements "to any educational institution or individual" to secure loan applications. The Secretary has never interpreted the reference to "individuals" as limited to employees of a school or a school-affiliated organization.

The Secretary notes that the reference to "processing" in paragraph (5)(i)(A)(5) of the definition of lender in § 682.200(b) was intended to convey, consistent with the Department's longstanding guidance, that the referring party was being compensated for some level of administrative work in processing the application, not just for forwarding the application to the originating lender. However, the Department understands that the term "processing" may be confusing and has clarified the language for purposes of the provision.

The Secretary believes that the payment of these referral fees should be treated as an improper inducement for several reasons. The growth of national lenders and banking means that the payment of referral fees paid to nonparticipating lenders is no longer necessary to ensure nationwide borrower

access to the FFEL Program. Moreover, most referral fee arrangements identified by the Department do not involve small local lending institutions, but involve payments by large lenders to school-related organizations. Finally, we note that with the adoption of the MPN and expanded eligibility standards, there is no longer any distinction between applications received and loans made, so there is no reason for distinguishing between them based on these different standards.

The Secretary further believes that payment of referral fees has eroded the integrity of the FFEL Program. Many of these fees are being paid to school-affiliated organizations that have access to certain personal information of students and alumni and are held in a certain level of esteem by students, alumni, and their parents. We believe that these arrangements and payments represent a conflict of interest for the organization and the school with which it is affiliated because the arrangement is interpreted as an endorsement of the lender by the organization and the school. Additionally, these fees do not appear to be paid to compensate the referring party for any administrative work done in processing the application, thus making them a prohibited inducement under the Department's standing interpretive guidance. The Department is also aware that such fees are being paid to individuals and organizations that are not under contract to any lender or its affiliate in an eligible lender trustee arrangement, and that operate as independent brokers collecting FFEL applications and marketing them to various FFEL lenders for the highest fee per application.

Finally, in response to the comments about small lenders who have referred borrowers in exchange for fees to satisfy other legal obligations, we note that the purpose of the FFEL Program is to provide loans for student and parent borrowers, not to provide an opportunity for lenders who do not participate in the program to meet other legal requirements. We expect that these lenders will find other appropriate ways to meet those requirements.

Changes: Paragraph (5)(i)(A)(5) of the definition of lender in § 682.200(b) has been modified to clarify that prohibited "processing" fees do not include fees paid to meet the requirements of other Federal or State laws.

Note also that the Higher Education Opportunity Act (P.L. 110-315), which was signed into law on August 14, 2008, amends the language in 435(d)(5) to read "to any institution of higher education or any employee of an institution of higher education". This replaces "individual" with "employee of an institution of higher education", narrowing the scope of the legislation. Prior to this amendment, however, a broader scope applied.

The language in section 435(d)(5) of the Higher Education Act of 1965 concerning prohibited inducements is "in order to secure applicants for loans". The language in the regulations at 34 CFR 682.200(b) parallels the statute, using "to secure applicants for FFEL loans". DCL 89-L-129 uses language "to secure applicants for Part B loans". The

final regulations published in the Federal Register on November 1, 2007 (which is effective July 1, 2008) amended 34 CFR 682.200(b) by adding "or to secure FFEL loan volume" to the language cited above and by adding bans on payments in exchange for "FFEL loan applications, application referrals, or a specified volume or dollar amount of loans made" among other activities. Since the Master Promissory Note (MPN) was introduced in 2000-01, there is no longer a distinction between receipt of a loan application and the origination of a loan.

The ban on inducements "to secure applicants" does not apply to payments for providing other services such as loan servicing. It is not uncommon for lenders to compensate servicers based on a percentage of loan volume or the number of borrowers. For example, the prospectus (Form 424B5) for the SLM Student Loan Trust 2007-8 provides for a servicing fee "not to exceed 0.50% of the outstanding principal amount of the trust student loans" on page S46, while the prospectus (Form 424B5) for the SLM Student Loan Trust 2008-1 provides for a servicing fee that is "calculated on a unit basis and will equal (i) \$1.50 per month per borrower for trust student loans that are in in-school status, (ii) \$2.75 per month per borrower for trust student loans that are in grace status and (iii) \$3.25 per month per borrower for all other trust student loans. ... In no event, however, will the primary servicing fee for any month exceed 1/12 of 0.90% of the outstanding principal balance of the trust student loans..." on page S-43.

However, whether ISL employees were compensated for servicing the loans is irrelevant, as ISL outsourced its servicing activities. The question at hand is whether any ISL employees were engaged in activities "to secure applicants", given that all were compensated in part based on the number of borrowers and/or loan volume. Compensating sales and marketing staff based on the number of borrowers is not permitted, as documented by the following excerpt from DCL 89-L-129: "Some financial incentives provided by lenders and guarantee agencies are expressly permitted by statute, and are therefore not subject to the statutory prohibition quoted above. Other activities provide some financial benefit to prohibited recipients of inducements, but are nevertheless permissible because the financial value of the benefit is nominal, or the activity is not undertaken to directly secure applications from individual prospective borrowers, but rather as a form of generalized marketing or advertising." The meaning of "generalized marketing or advertising" is clarified to mean low-cost trinkets and tchotchkes in item #8 of the list of examples of permissible activities from the DCL: "A lender or guarantee agency sponsors a luncheon for a recognized organization of schools or a school trade association, provides free pens with the lender's or agency's name inscribed thereon, or provides some other item of nominal value as a form of advertising or creation of good will, rather than as a quid pro quo for loan referrals." Commission based compensation to secure applicants for federal loans could be deemed a quid pro quo exchange which would not be permitted.

ISL has corrected this problem in the CPC incentive plan.

ISL Executive Compensation Not Excessive

A review of executive compensation for non-profit education lenders, as listed in the IRS Form 990 filings for 2005, shows ISL's executive compensation to not be excessive as compared with other non-profit education lenders. Table 6 lists total compensation for several comparable non-profit education lenders, including ISL. This table does not include compensation from for-profit entities associated with the non-profit lenders, since that information is not disclosed in the IRS Form 990 filings.

Table 6: Comparison of Executive Compensation for Non-Profit Education Lenders

Lender	Executive	Total Compensation
Access Group	Dan Lau	\$439,567
CHELA	Douglas Dolton	\$625,182
ISL	Steve McCullough	\$246,702
NHHELCO	Rene A. Drouin	\$462,009
PHEAA	Dick Willey	\$469,975
SCSLC	William M. Mackie, Jr.	\$257,988
TGSLC	Sue C. McMillin	\$282,428

Source: 2005 IRS Form 990.

Above-Average Borrowing

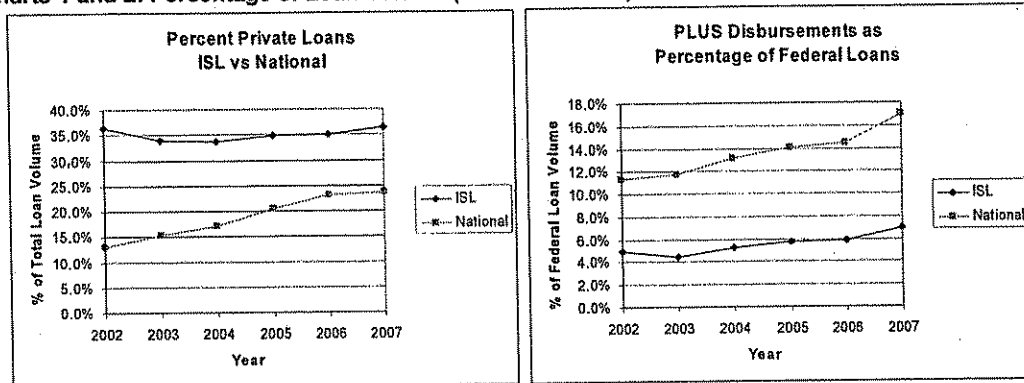
It is unknown how much of the above-average growth in Iowa borrowing levels is due to the growth of the gap between college costs and need-based aid and how much due to other factors. While the gap is certainly a factor, it may not be the only factor.

ISL's private loans exhibit a similar proportion of total loans over the years. So if there is excessive growth in borrowing, it is consistently distributed across the various types of loans (federal vs. private) and the number of borrowers and not necessarily attributable to a change in the volume for any one type of loan. This leaves the possibilities of either a higher overall amount of borrowing per student or a greater percentage of enrolled students borrowing, or both.

However, PLUS loans represent a much lower percentage of ISL's loan volume and ISL's private student loans a much higher percentage as compared with national data, as illustrated by the following charts.⁶³ This suggests a consistent annual shifting of borrowing from PLUS loans to ISL's private student loans.

⁶³ ISL data is based on the Iowa Student Loan Disbursements spreadsheet provided by ISL. National data for federal loans is based on the President's Budget Baseline spreadsheets for FY2009. National data for private student loans is based on the College Board's Trends in Student Aid 2007 publication.

Charts 1 and 2: Percentage of Loan Volume (ISL vs. National) for Private and PLUS Loans



Source: ISL Student Loan Disbursements spreadsheet; President's FY2009 Budget Baseline spreadsheets; College Board Trends in Student Aid 2007.

Recommendations

Key recommendations include requiring additional disclosures to prospective borrowers, changes in ISL lending practices, improvements in ISL oversight and management, and elimination of conflicts of interest inherent in ISL compensation practices. Some of these recommendations have already been incorporated into the new statute enacted by the Iowa legislature (HF 2690, May 5, 2008) and the Higher Education Opportunity Act of 2008 (P.L. 110-315, August 14, 2008) enacted by Congress.⁶⁴

Disclosures:

1. ISL should include a disclosure statement in its marketing materials and web site that the Stafford loan is less expensive than ISL's private student loan products.⁶⁵
2. ISL should remove all language that states or suggests that it provides the lowest cost student loans (or other superlative expressions) and instead may state that it provides low cost loans or lower cost loans or competitive loans.
3. ISL should be required to include total life-of-loan interest payment figures (or total payments) in any marketing materials that discuss reductions in the monthly

⁶⁴ Title X of the Higher Education Opportunity Act of 2008, also known as the Private Student Loan Transparency and Improvement Act of 2008, amends the Truth in Lending Act (15 USC 1631 et seq.) to apply to private student loans by adding section 128(e). These amendments require up-front disclosure of key characteristics of private student loans, including the potential range of rates and fees, limitations on interest rate adjustments (frequency and amount), whether the rates are fixed or variable and the loan term in years. The amendments require disclosure of an estimate of the total cost of the loan over the life of the loan using the maximum interest rate offered by the lender (with and without capitalization of interest). After loan approval the lender is required to provide an estimate of the total cost of the loan over the life of the loan with the actual terms provided to the borrower. The lenders are also required to disclose that the borrower may qualify for federal student aid and to disclose the interest rates on federal student loans. The amendments also require a 30-day lock on the terms of the loan (with only the index varying) and a 3-day buyer remorse period after consummation. The amendments do not, however, require similar disclosures for federal education loans. The amendments also do not require school certification of private student loans before the loans can be consummated.

⁶⁵ In particular, all brochures for ISL's private loans should include a statement encouraging families to consider borrowing from federal loans such as the Stafford and PLUS loans before borrowing from private loan programs.

payments. These figures should be displayed in a clear and conspicuous manner in close proximity to and in the same dominant typeface and point size as the reductions in monthly payments. In addition, ISL should be precluded from characterizing a reduction in the monthly payment as saving money when it involves an increase in the total payments.

4. Any marketing materials that refer to the maximum amount obtainable under ISL's loan discount programs should be required to disclose an estimate of the percentage of ISL's borrowers who will likely obtain the full discount.
5. ISL should be required to tell borrowers that they are not required to borrow from ISL's federal and private loan programs and may obtain their education loans from any lender.
6. ISL has improved the disclosures on its web site since the onset of the Attorney General's investigation. These improvements should be made mandatory.
7. The fine print disclosures on marketing materials should be required to be printed in at least a minimum type size to enhance readability.

Lending Practices:

8. ISL should require borrowers to have exhausted their subsidized and unsubsidized Stafford loan eligibility before becoming eligible for ISL's private student loans.⁶⁶ For example, dependent undergraduate juniors and seniors are eligible to borrow up to \$7,500 in Stafford loans for the 2008-09 academic year and independent undergraduate juniors and seniors are eligible to borrow up to \$12,500. An undergraduate junior or senior who is eligible for the Stafford should not be permitted to borrow from ISL's private student loan program until he or she has borrowed these maximum amounts, as federal loans are cheaper, more available and have better repayment terms than private student loans.

Oversight and Management:

9. ISL should expand its benchmarking to include the loan programs offered by other nonprofit state loan agencies.
10. Individuals who serve on ISL's board to represent the interests of the state should not be paid for this service by ISL, as that would represent a conflict of interest.
11. It might be worthwhile to separate the advisory and oversight functions of the ISL board or to institute independent monitoring. Making ISL subject to open records laws might provide an opportunity for such monitoring by news media.

Employee Compensation:

12. ICAN and CPC compensation should not be dependent in any way on the number of ISL's loan applications, borrowers or funded loans, nor on any ISL-specific performance measures.

⁶⁶ A memo dated December 16, 2007 states that "Students must take all of the guaranteed student loans for which they are eligible before accessing the Partnership Loan" so this recommendation may already be in use by ISL.

It would be worthwhile to consider generalizing some of these recommendations to apply to all lenders offering education loans to Iowans or to or on behalf of students enrolled in Iowa colleges. As a non-profit Iowa institution, ISL has a greater responsibility to Iowans. Nevertheless, these recommendations include several best practices that should be adopted by (or imposed on) all education lenders.

In addition, the draft Iowa Standards for Private Lending and Iowa Student Loan Code of Conduct seem to be reasonable and should be adopted, with a few changes:

- Insert “or to cosign the student's private student loans” after “parents and other credit worthy benefactors will be encouraged to borrow on the student's behalf”.
- Counseling should be personalized to the borrower's debt, providing information about the monthly loan payments, total payments over the life of the loan, and total interest paid over the life of the loan. Discussions of interest rates and APR⁶⁷ are insufficient when counseling student borrowers as they are too abstract. Any comparisons of loans with different loan terms should be made using the same loan term (say, a 10 year term) in order to permit an apples-to-apples comparison.
- Repayment examples involving loan discounts should be required to disclose the best, worst and typical figures for the discounts. Typical or average discounts should take into account the likelihood with which borrowers actually qualify for and obtain the specified discount.
- There should be a ban on payments to organizations closely affiliated with the colleges, such as alumni associations and booster clubs.
- There should be a ban on paid advisory board service.
- Ban preferential packaging, where the school lists a particular lender on its award letters and/or provides borrowers with master promissory notes or loan applications (online or printed) with the lender's name pre-filled.
- Require any sale of ISL loans to preserve and maintain the loan discounts available to the borrowers. Also require any lenders that sell loans to ISL to disclose this in any preferred lender list that recommends the lender.
- Ban lender payments of printing costs, revenue sharing, referral fees, lender payments to financial aid administrators, and private labeling of a lender's loan with the school's name, logo or mascot.

⁶⁷ APR and monthly payments are lousy tools for comparing loans of different loan terms. All else being equal, the loan with the longer loan term will have a lower APR and lower monthly payment because of a longer amortization. For example, compare the Stafford loan (6.8% interest and a 10-year term) with a private student loan (10.5% interest and a 20-year term). On a \$20,000 loan the Stafford loan has monthly payments of about \$230 and total interest paid over the life of the loan of about \$7,619. On the private student loan the monthly payment is about \$200 and the total interest paid over the life of the loan is about \$27,920. Focusing on the monthly payments without disclosing the impact on total interest paid makes the private student loan appear cheaper (“more affordable”) when in fact it is ultimately much more expensive to the borrower. This is misleading, especially with borrowers who are not financially literate. Comparisons of monthly loan payments should be based on the same loan term, so that the loans are compared on an equal basis. (It is in a lender's best interest to encourage borrowers to choose a longer loan term because a longer loan term is more profitable to the lender.)

- The language banning opportunity loans “in exchange for other specified loan volume” should be expanded to ban opportunity loans made in exchange for other benefits to the lender, such as placement on the preferred lender list.

Other loan industry guidelines are deliberately weaker than the code of conduct established by the New York Attorney General and so should not be relied upon. These non-binding guidelines include:

- Student Loan Business Practices⁶⁸ endorsed on April 24, 2007 by the Education Finance Council (EFC) and National Council for Higher Education Loan Programs (NCHELP).
- Guidelines for FFELP Industry Practices⁶⁹ which were endorsed by Consumer Bankers Association (CBA), EFC and NCHELP in November 2004.
- Education Loan Customer Commitment⁷⁰ issued on May 25, 2007 by the Consumer Bankers Association (CBA).

⁶⁸ www.nchelp.org/elibrary/ReferenceMaterials/IndustryBestPractices/Student%20Loan%20Business%20Practices%20--%20EFC%20&%20NCHELP%20April%202007.pdf

⁶⁹ www.nchelp.org/news/inducementguidelines11-16-04.pdf

⁷⁰ www.cbanet.org/Issues/Student_Lending/documents/CBA-Cust-Commit%205-2007-FINAL.pdf

Appendix A – About the Author

Mark Kantrowitz is a nationally recognized expert on student financial aid, including scholarships and student loans. He is publisher of FinAid, the most popular and comprehensive web site for student financial aid information, advice and tools. He is also director of advanced projects for FastWeb, the largest and most frequently updated scholarship matching web site. Both web sites are made available to the public for free. Mark is also the author of *FastWeb College Gold: The Step by Step Guide to Paying for College* (Collins, September 2006), which was among the top 100 bestselling books on Amazon.com.

As a national expert, Mark has been called to testify before Congress about financial aid on several occasions. Most recently he testified before the Senate Committee on Banking, Housing and Urban Affairs in a hearing entitled *Turmoil in US Credit Markets: Impact on the Cost and Availability of Student Loans* on April 15, 2008. Several of the solutions he proposed in his white paper, *Solving the Student Loan Credit Crunch*,⁷¹ have subsequently been enacted by Congress and implemented by the Federal Reserve and the US Department of Education.

Mark Kantrowitz is routinely interviewed by hundreds of the nation's news outlets, including the Wall Street Journal, New York Times, Washington Post, Los Angeles Times, San Francisco Chronicle, Boston Globe, Chicago Tribune, USA Today, the Associated Press, Reuters, Bloomberg, SmartMoney, Money Magazine, Kiplinger's, US News & World Report, Newsweek, MSN, CNN, CNBC, NBC, ABC, CBS, Inside Higher Ed and the Chronicle of Higher Education. He is consulted by financial aid administrators, professional associations and federal agencies nationwide, and is on the editorial board of the Council on Law in Higher Education and the editorial advisory board of Boardroom Inc.'s Bottom Line/Wealth. He is also the *Student Loan Guru* for FiLife.com, a Dow Jones Inc./IAC property.

Mark's work in financial aid has been recognized by many awards, including a Meritorious Achievement Award from the National Association of Student Financial Aid Administrators, a Special Award from the College Board, the President's Award from the National Association of Graduate and Professional Students, and the Jefferson Medal from the American Institute for Public Service. He was also recently named the Pennsylvania state finalist for the Above & Beyond Citizen Honors of the Congressional Medal of Honor Society.

Selected publications include:

- Mark Kantrowitz, *The Financial Value of a Higher Education*, Journal of Student Financial Aid 37(1):18-27, NASFAA, July 2007.
- Mark Kantrowitz, *Evaluating Student Loan Discounts*, Student Aid Transcript 18(2):32-38, NASFAA, July 2007.
- Mark Kantrowitz, *Standardize Financial Aid Award Letters*, Inside Higher Ed, June 22, 2007.

⁷¹ <http://www.finaid.org/educators/2008-03-10studentloancreditchrisis.pdf>

- Leo Kornfeld and Mark Kantrowitz, *A New 'Independence' Day for Student Financial Aid*, Chronicle of Higher Education 53(23):B11-B12, February 9, 2007.
- Mark Kantrowitz, *Analysis of the College Student Relief Act of 2007*, Emerging Issues in Financial Aid, Council on Law in Higher Education, Volume 1, Number 1, January 23, 2007.
- Mark Kantrowitz, *Student Aid Impact of the Higher Education Reconciliation Act of 2005*, Regulatory Advisor, Council on Law in Higher Education, Volume 2, Number 2, March 2006.
- Mark Kantrowitz, *Limitations on School Relationships with Education Lenders*, Regulatory Advisor, Council on Law in Higher Education, Volume 1, Number 3, May 2005.

Mark is ABD on a Ph.D. in computer science from Carnegie Mellon University (CMU), has a Masters degree in computer science from CMU and Bachelor of Science degrees in mathematics and philosophy from the Massachusetts Institute of Technology (MIT) and is an alumnus of the Research Science Institute program established by Admiral H.G. Rickover. He is a member of the board of trustees of the Center for Excellence in Education.

Appendix B – ISL's Mission

This appendix summarizes key representations concerning Iowa Student Loan's mission made in its articles of incorporation, the Iowa Code, memos from ISL's CEO and on the ISL web site (www.studentloan.org).

Iowa Code

Iowa Code section 261.38 permits the Iowa College Student Aid Commission to enter into agreements with ISL "in order to increase access for students to education loan programs that the commission determines meet the education needs of Iowa residents". Such loans may not exceed COA-Aid per IRC 144(b)(1)(B).

ISL Memos

ISL memo #6 (dated July 26, 2007 memo from Steve McCullough, CEO of ISL, to the Iowa Attorney General) represents that "ISL's goal has always been to offer the lowest cost student loans available to Iowans" and that "ISL's board of directors periodically requests analysis from staff to ensure this goal is met".

ISL memo #1 (dated July 26, 2007 memo from Steve McCullough, CEO of ISL, to the Iowa Attorney General) represents that "ISL's commitment to students and parents is also demonstrated by its long track record in supplying the lowest cost loans available to Iowans, both in terms of guaranteed student loans and private student loans. Students and parents who borrow under other programs, including Direct Lending, are disadvantaged because they are paying more than necessary for their student loans".

ISL memo #1 also represents "... ISL's primary concern is the well being of Iowa's college student[s] and their parents. ISL is driven by its non-profit mission, which is also how it measures its success." The memo then cites ISL's loan forgiveness programs for teachers and nurses, loan discount programs (fee waivers and interest rate reductions), and loan losses on its private loan program "mostly made to students whose parents were unable or unwilling to pay tuition, co-sign or borrow on their student's behalf". ISL represents that the "funding levels for programs are unprecedented among non-profit secondary markets".

Other ISL Documents

The document "Section 4 -- Rates and Terms for Iowa Student Loan Borrowers" states: "In accordance with its mission, Iowa Student Loan strives to provide Iowa borrowers with the best possible rates and terms. To this end, staff at Iowa Student Loan periodically gather information about competitors (including the Direct program) and periodically report many aspects of loan rates and terms to its board of directors, who are responsible for setting those terms."

The coversheet⁷² to the “Comprehensive Current Comparison of Loans” compiled as of 3/31/2007 stated:

Iowa Student Loan – Offering the Lowest Cost Loans to Iowans
(Compiled as of 3/31/2007)

In meeting its important goal of low-cost lending, the management of Iowa Student Loan compiles comparison charts, which include the loans offered by Iowa Student Loan and its lender clients, those offered under Direct Lending, and those offered by Iowa Student Loan’s private-sector competitors. Attached is the latest version of this analysis.

The compilation clearly illustrates that students and families have many choices when it comes to higher education financing. It also shows that in every category – Stafford Loans, PLUS Loans, Consolidation Loans and Private Loans – Iowa Student Loan offers the best loans available to Iowans. More concisely, students and parents are best-served by working with Iowa Student Loan and its lenders. When college financial aid officers educate their students and their families about all the options available to them for financing higher education, they include Iowa Student Loan because the corporation is the lowest cost provider in the state, year after year.

Questions have been raised in other parts of the country about whether students and parents are being adequately served and educated about all of the student loan options available to them. In Iowa, ISL offers the best options, both for federally guaranteed loans and private loans. The process is transparent and Iowa Student Loan marshals all of its resources to ensure students and families have access to the best, lowest cost option possible to help meet their specific needs.

...

Other observations:

Iowa Student Loan’s FFELP loan APRs are better than those of competitors and Direct Lending.

Iowa Student Loan’s credit-worthy, variable rate loan has a lower APR than the fixed rate Direct PLUS Loan, making it a viable and attractive alternative for parents.

⁷² From context it appears that this copy of the comparison chart was intended for members of Congress.

Des Moines Register

ISL's CEO was quoted in the October 29, 2007 issue of the Des Moines Register⁷³ as stating "As does any other competitor, ISL has to earn this business by providing the best terms for Iowa's students and families."

ISL's Web Site

www.studentloan.org/About-Us/Frequently-Asked-Questions.aspx

Iowa Student Loan offers a wealth of innovative products and services, developed specifically to best serve Iowa students and families, particularly those who would not otherwise be able to afford a college education.

...

Q. As a nonprofit, does Iowa Student Loan offer loans for low- and middle-income borrowers at better terms than other lenders, and does it make loans available under terms not offered by other lenders?

A. Iowa Student Loan offers competitive federal and private student loans. ... Some private loan providers, however, reject a large percentage of applicants, charge high interest rates and fees, offer complex terms and conditions, and do not disclose the credit requirements applicants must meet to receive the interest rate they are publicizing.

The following is a summary of the Iowa Student Loan Partnership Loan Program.

- Availability of private loans at favorable rates.
- Accepts borrowers who would be rejected by all other providers and absorbs the resulting loan losses.
- Publicizes all of its interest rates so that consumers know what to expect.
- Trains college financial aid advisors on how to evaluate private loans based on their "all-in" Annual Percentage Rates, and how to spot deceptive offerings.
- Requires college financial aid officers to certify the eligibility of borrowers to prevent them from over borrowing or using loans for non-education expenses.
- Encourages students and parents to always borrow under the federal student loan programs prior to considering private loans.
- Requires students to complete budget work sheets as part of the application process to ensure they understand how much they are borrowing, their projected future loan payments and the impact they will have on their disposable income.
- Presents financial literacy seminars at high schools and college campuses to educate students on how to manage money.
- Offers services to help students find scholarships and grants, minimize their college borrowing and offers tips to succeed in college.

⁷³ News media occasionally misquote sources. This quote should not be treated as an accurate representation of what ISL's CEO said unless confirmed by ISL.

www.studentloan.org/About-Us/Helping-Iowans.aspx

It has proven advantageous to Iowans that Iowa Student Loan is the main holder of student loans in the state. Iowa Student Loan offers students the lowest possible interest rates.

<http://www.studentloan.org/About-Us/About-Us.aspx>

Iowa Student Loan was established in 1979 as a private, nonprofit corporation with a mission to help students and parents obtain the financial resources needed to fund postsecondary education.

<http://www.studentloan.org>

Iowa Student Loan is a nonprofit organization that helps students and parents obtain the necessary resources for higher education.

<http://www.studentloan.org/plp.htm> (as of 04/10/2001)

Your choice of competitive interest rates. You choose between a fixed or variable rate loan. Both loans are extremely competitive with the Federal PLUS Loan and other private loan options.

<http://www.studentloan.org/index.htm> (as of 6/3/2004)

News Release

Iowa Student Loan Gives Borrowers Lowest Rates on Consolidation Loans

<http://www.studentloan.org/> (as of 1/11/2006)

As a non-profit, we give back to students by offering money-saving benefits on student loans.

Appendix C – ISL Marketing Materials

This appendix contains selected ISL marketing materials referenced in this report.



"By consolidating my student loans, I was able to lower my payment by over \$100 and have more money for the other stuff I need every month."
Eric P. – ISL Consolidation Borrower

Great Reasons to Consolidate with IOWA STUDENT LOAN®

Dear Student Loan Borrower,

Are you struggling to make your student loan payment each month? Frustrated with having to deal with multiple student loan companies? Or, have you just heard all the talk about low student loan interest rates? Good news ... you have been pre-approved for an Iowa Student Loan consolidation loan – call today to lock in today's incredibly low rate and then lower that rate by an additional 1% with our rate reduction program. And, reduce your stress with a more manageable monthly payment.

1. Lock in your interest rate at historic lows!

Interest rates have never been lower! Lock in your rate today and have peace of mind that your rate will never increase.

Bonus Savings!

2. Save money when you lower your interest rate an additional 1%!

Lenders calculate your basic interest rate in the same way (a weighted average of your current loans). But, with Iowa Student Loan, you can reduce this interest rate by an additional 1% in just 6 months! Just use our automatic payment plan and make your first six monthly payments on time!

.25% **.75%** ➔ **Save over \$1,000**
...when your payments are and ...when you make your first six **on every \$8,000²**
withdrawn automatically! monthly payments on time!

Start experiencing these savings in just six months!!

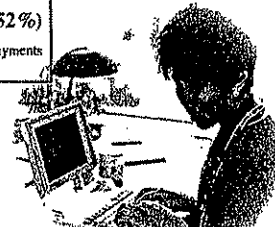
3. Lower your monthly payment by up to 52% ... more money in your pocket!

Loan Amount	\$15,000	\$30,000	\$50,000
Your Current Payment	\$147	\$295	\$491
Your New Monthly Payment	\$103	\$165	\$234
Reduction In Your Monthly Payment	\$44 (30%)	\$130 (44%)	\$257 (52%)

In table, current payment amounts are based on 10-year term, level payment plan and 3.37% interest rate. Consolidated payments (or New Monthly Payment) are based on 2.875% interest rate, maximum term for loan amount, and level payment plan.

Act Today!

Apply online at www.studentloan.org/loancons
or call 800-243-7552 (press 2,2,3) today!



"I was looking for the best rate and wanted my loans to be in one place."
ISL Consolidation Borrower

Important Information:

Information from a credit bureau was used in conjunction with this offer. You were selected based on information contained in your consumer report from Trans Union LLC and final acceptance is subject to your ability to meet our full eligibility requirements. The eligibility requirements are as follows: 1) You must have at least \$3,000 in eligible student loans. 2) You must not have loans more than 180 days delinquent, and 3) You must be in your grace period prior to repayment or in repayment on your student loans. If, at the time of offer, you do not meet the initial criteria, we may not consolidate your loans. You can exclude your name from any future lists prepared by the credit bureau for future preapproved solicitation by writing: TransUnion, LLC, Attn: Marketing Opt Out, P.O. Box 97328, Jackson, MS 39288-7328 or by calling 1-888-3OPTOUT. Please consider: Since you will be paying interest over a longer time period, consolidation of your loans may increase the total amount repaid.

¹ Consolidation benefits apply to consolidation loan applications received after 01/01/01. If statutory, regulatory or other changes occur that adversely impact Iowa Student Loan (ISL), ISL reserves the right to withdraw these benefits. Benefits will not be withdrawn for borrowers who are already eligible.

² Savings equals the difference between the amount paid if no rate reduction were received and the amount paid if both the .75% and .25% rate reductions mentioned above are received. The example assumes a consolidated loan amount of \$30,000, a 20-year term, a 2.875% interest rate, and the level payment plan.

Consolidate your Federal Student Loans today!

Lower your monthly payment for more money in your pocket

**Lower your
payment up
to 52%***

Loan Amount	\$15,000	\$30,000	\$60,000
Impact Before Consolidating	\$200	\$400	\$800
Impact After Consolidating	\$100	\$200	\$400
Monthly Payment Savings	\$100	\$200	\$400

Additional benefits to save even more on your consolidated loans

For loan balances less than \$60,000
you receive:

- **1.00%** interest rate reduction after first 12 on-time payments.*
- **.25%** interest rate reduction for using auto-debit.

*Borrowers who: 1) currently reside outside of Iowa, or 2) have never received student loans while attending an Iowa College, or 3) were not Iowa residents when receiving student loans will receive this benefit after 24 on-time payments.

**Save \$2,609 in interest
on every \$10,000**

For loan balances \$60,000 or more
you receive:

- **1.25%** interest rate reduction after first 12 on-time payments.
- **.25%** interest rate reduction for using auto-debit.

**Save \$6,162 in interest
on every \$10,000**



"Consolidating was worth my time! I lowered my monthly payments and am saving thousands!"

— D. Beck



IOWA STUDENT LOAN®

Call Iowa Student Loan or apply online.
We'll help you through the process, step by step.

(888) 266-7651
www.studentloan.org

The following excerpt from the fine print of the previous brochure is enlarged for readability. It appears in 7 point type in the original.⁷⁴ The main font sizes used in the body of the brochure were 9, 10 and 16 point.

Details on savings:

- ¹ In the repayment chart, Payments Before Consolidating are based on a 7.14% interest rate, 10-year term and level payment plan. The Payments After Consolidating are based on a 6.625% interest rate and maximum allotted time for loan amount under the graduated payment plan; the payments represent the payment amount for the first 24 months. The graduated payment plan begins with lower payments and increases over time.
- ² The savings on the preceding page equals the difference between the amount paid if none of the benefits discussed on the preceding page are received and the amount paid if each of the benefits discussed are received. The example assumes a consolidated loan amount of \$30,000, a 20-year term, a 6.625% interest rate, and the level payment plan. The 1.00% interest rate reduction remains in effect as long as the borrower continues to make on-time payments.
- ³ The savings on the preceding page equals the difference between the amount paid if none of the benefits discussed above are received and the amount paid if each of the benefits discussed are received. The example assumes a consolidated loan amount of \$60,000, a 30-year term, a 6.625% interest rate, and the level payment plan. The 1.25% interest rate reduction remains in effect as long as the borrower continues to make on-time payments.

⁷⁴ Mark Kantrowitz was a member of the advanced development group of Bitstream Inc. from 1986 to 1989 and helped develop their typeface development and hinting technology. He is qualified to evaluate the font size of print samples. This determination of the font sizes assumes that the PDFs supplied by ISL were not enlarged or reduced during preparation.

Great Reasons to Consolidate with Iowa Student Loan



"Since consolidating, my monthly income has been able to be spread around and cover more of my expenses."

**Have more money in your pocket each month ...
lower your monthly payment by up to 60%!**

Get a lower and more manageable monthly payment with Iowa Student Loan's I-CHEERS consolidation program. I-CHEERS combines all of your eligible federal student loans into one and extends the repayment term.

And, make only one payment to one company each month!

Loan Amount	\$15,000	\$30,000	\$50,000
Your Current Payment	\$184	\$368	\$613
Your New Monthly Payment	\$112	\$184	\$242
Reduction in Your Monthly Payment	\$72(39%)	\$184(50%)	\$371(60%)

In the above table, current payment amounts are based on a 10-year term and 8.25% interest rate. Consolidated payments based on a 4.125% interest rate, maximum allowed term for loan amount, and level payment plan.

**Make early payments or higher than scheduled payments
at any time with no penalty!!**

**Have peace of mind knowing you are paying less
because you locked in your rate at historic lows!**

On July 1, 2002, student loan interest rates dropped to historic lows. Consolidate and benefit from the extraordinary low rates!



"I was looking for the best rate and wanted my loans to be in one place!"

Bonus Savings...

Save even more with our special interest rate reduction program. You can receive:

.25%

... when your payments are withdrawn automatically!

.75%

... when you make just your first six monthly payments on time!

**Save over \$2,100
on every \$7,500!**

Start experiencing these savings in just six months!

**Call Iowa Student Loan at
800-243-7552, press 2, 2, 2
or visit us at www.studentloan.org**

*To be eligible, borrowers must have loans totaling at least \$5,000 and be in their grace period prior to repayment or in repayment.

†Savings equals the difference between the amount paid if no rate reduction were received and the amount paid if both the .75% and .25% rate reductions mentioned above are received. The example assumes a consolidated loan amount of \$23,500, a 10-year term, and the level payment plan. Consolidation benefits apply to consolidation loan applications received after 01/01/03. If a money, origination, or other charges occur that adversely impact Iowa Student Loan (ISL), ISL reserves the right to withdraw these benefits.

The fine print in this brochure was in 6 point type.

Consolidate your Federal Student Loans today!

Lower your monthly payment for more money in your pocket.

Lower your
payment up
to 52%¹

Total Loan Amount	\$15,000	\$30,000	\$60,000
Payment Before Consolidating	\$175	\$350	\$700
Payment After Consolidating	\$84	\$163	\$325
Your Monthly Payment Savings	\$91	\$187	\$375

Additional benefits to save even more on your consolidated loans!

For loan balances less than
\$60,000 you receive:

- 1.00% interest rate reduction after first 24 on-time payments.
- .25% interest rate reduction for using auto-debit.

For loan balances \$60,000
or more you receive:

- 1.25% interest rate reduction after first 12 on-time payments.
- .25% interest rate reduction for using auto-debit.

Save \$2,385 in interest
on every \$10,000²

Save \$6,162 in interest
on every \$10,000³



"Consolidating was worth my time! I lowered my monthly payments and am saving thousands!"

- D. Beck



FEDERAL
STUDENT LOAN
CONSOLIDATION
PROFESSIONALS™

Call or apply online today. We'll help you through the process step by step.

(800) 390-6943

www.ConsolidationProfessionals.com/SaveToday

¹ In the repayment chart, Payments Before Consolidating are based on a 7.14% interest rate, 10-year term and level payment plan. The Payments After Consolidating are based on a 6.625% interest rate and maximum allotted time for loan amount under the graduated payment plan; the payments represent the payment amount for the first 24 months. The graduated payment plan begins with lower payments and increases over time.

² The savings above equals the difference between the amount paid if none of the benefits discussed above are received and the amount paid if each of the benefits discussed are received. The example assumes a consolidated loan amount of \$30,000, a 20-year term, a 6.625% interest rate, and the level payment plan. The 1.00% interest rate reduction remains in effect as long as the borrower continues to make on-time payments.

³ The savings above equals the difference between the amount paid if none of the benefits discussed above are received and the amount paid if each of the benefits discussed are received. The example assumes a consolidated loan amount of \$60,000, a 30-year term, a 6.625% interest rate, and the level payment plan. The 1.25% interest rate reduction remains in effect as long as the borrower continues to make on-time payments.

Headed to College? Start Here!

Planning and funding YOUR college education does not have to be complicated. Start by reading this brochure, and if you have questions, please contact one of the resources listed on the following pages.

The lender listed below has partnered with Iowa Student Loan®, a private, non-profit corporation, to disburse and service its student loans. Iowa Student Loan can be reached at 800-243-7552 or www.studentloan.org.

1 out of 3 students needs loans to help pay for college.

If you are one of these students, you need to know that
not all student loans are alike!

- Q. What makes the loans offered by the lender listed in this brochure different from other Federal Stafford Loans?
- A. Borrower benefits that save you money when you obtain your loans and during repayment. Refer to the savings examples below.
- Q. Who can obtain one of these loans?
- A. Students attending any college in the country that participates in the Federal Family Education Loan Program (FFELP). See page 6 for details.
- Q. How do you obtain a loan from the lender listed in this brochure?
- A. Respond to the college with the lender name and code that appears below on the college's form or Master Promissory Note (MPN).

More money in your pocket...

Save \$150
on every \$5,000!

Zero fees!

Save \$350
on every \$5,000!

Lower your interest
rate by 2.5% with
on-time payments!

Total savings of
\$500 on
every \$5,000!

Use this money for the
practical things you need
...not for fees and interest.

...with our Federal Stafford Loans!

The lender listed below offers Federal Stafford Loans to students and Federal PLUS Loans to parents. See page 4 for the Federal PLUS Loan borrower benefit.

To obtain your Federal Stafford or Federal PLUS Loan from the lender listed below, please respond to your college with this name and lender code by writing it on the Master Promissory Note, the form provided by your college or by indicating it on the online MPN.

1. All Federal Stafford Loan borrowers who utilize an eligible Iowa Student Loan lender qualify for Iowa Student Loan to pay the 3% origination fee. The 2.5% interest rate reduction is available after 48 on-time payments. This savings is realized as borrowers begin paying less interest after month 48, and, as such, borrowers are able to pay off the loan balance early and pay less overall. Total savings is based upon Iowa Student Loan paying the 3% origination fee on behalf of the borrower, an interest rate of 8.25%, immediate repayment, ten-year repayment term, and 48 on-time payments.

Iowa Student Loan intends to offer the benefits listed above for loans made through at least April 30, 2006, unless statutory, regulatory or other changes occur that adversely impact Iowa Student Loan or its participating lenders. These benefits are reviewed and extended on an annual basis.

MAGNIFY STUDENTS' SAVINGS

Iowa Student Loan Liquidity Corporation (Iowa Student Loan) participating lenders can magnify borrowers' savings on Federal Stafford and PLUS loans. Borrowers will qualify for the following benefits for loans disbursed on or after May 1, 1999.

0.50% Guarantee Fee Payment*: Iowa Student Loan will pay, on behalf of the borrower, up to 0.50% of the loan balance toward the guarantee fee on all Federal Stafford and PLUS loans.

3.00% Origination Fee Payment*: Iowa Student Loan will pay, on behalf of the borrower, up to 3.00% of the loan balance toward the origination fee on Federal Stafford Loans.

Federal PLUS Loan Credit*: Iowa Student Loan will credit Federal PLUS Loan accounts after disbursement of the loan for an amount that is 3.00% of the principal loan balance.

Interest Rate Reduction*: Additionally, borrowers can qualify for a 2.50% interest rate reduction on Federal Stafford Loans for the remaining term of the loan after making 48 on-time payments.

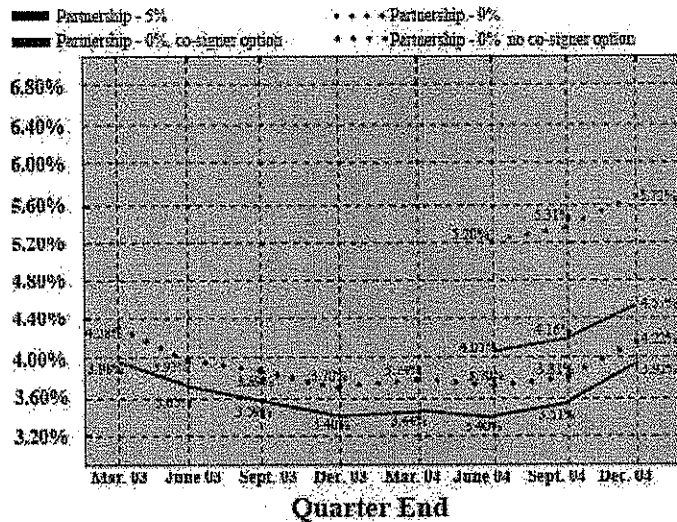
IOWA STUDENT LOAN PAYS:

Federal Stafford Loans				
Loan Amount	0.50% Guarantee Fee*	3.00% Origination Fee*	2.50% interest reduction after 48 on-time payments**	TOTAL SAVINGS (the APR is 6.68%)*
\$5,000	\$25	\$150	\$337	\$512
\$15,000	\$75	\$450	\$1010	\$1535

* Benefits effective on loans disbursed on or after May 1, 1999.

** Savings are based on the following: This is an immediate repayment loan, with a repayment term of 120 months and an interest rate of 7.46%. The 3.00% origination fee and up to 46% of the guarantee fee is paid on the borrower's behalf (increasing the loan proceeds that the borrower receives). The 2.50% interest rate reduction is provided after 48 on-time payments. The finance charge on the \$5,000 loan is \$1,773 and the finance charge on the \$15,000 loan is \$5,318. For more detailed information and conditions of the program, call Iowa Student Loan at 800-542-6005. Iowa Student Loan reserves the right to discontinue or change this program. Changes to the program, if any, will not affect the benefits for which the loan has already qualified.

Historical Approximation of Interest Rates for the variable rate Partnership Loan



The historical interest rate for the Partnership-5% Loan equals Iowa Student Loan's Cost of Funds (COF) Index IV plus 2.30%; plus 2.60% for the Partnership-8% Loan; plus 2.95% for the Partnership-0% Loan (co-signer option); and plus 4.10% for the Partnership-0% Loan (no co-signer option). Past approximations of Iowa Student Loan's COF Index IV are based on historical data. Iowa Student Loan can make no assurance that this historical data will be predictive of future interest rates. This is not the annual percentage rate to the borrower; it does not include origination fees. (See Partnership Loan at a Glance for APK examples).

ATTACHMENT 3

MEMORANDUM OF UNDERSTANDING

with

IOWA STUDENT LOAN LIQUIDITY CORPORATION

A. INTRODUCTION

This Memorandum of Understanding is between the STATE OF IOWA ex rel. Attorney General Thomas J. Miller and Iowa Student Loan Liquidity Corporation, ("ISL").

1. Iowa Student Loan Liquidity Corporation ("ISL"), is an Iowa non-profit corporation, with a business address of 6775 Vista Drive, West Des Moines, Iowa, and was established in 1979 to offer student loan programs to enhance the ability of Iowans to attend Iowa private colleges, community colleges and universities by acting as a secondary market for federal student loans, issuing its own private student loans, and educating students and their parents about financing higher education.

2. "ISL," as used herein, includes ISL and all of its agents, employees, officers, directors, successors and assigns, and any individuals and entities through which ISL engages in practices addressed in this Memorandum of Understanding.

3. Thomas J. Miller is the duly elected Attorney General of Iowa. As used herein, "Attorney General" refers to Attorney General Miller and the staff of the Office of the Attorney General of Iowa.

B. THE ATTORNEY GENERAL'S CONCERNS

1. The Attorney General is concerned that ISL advertised student loan consolidation loans which the Attorney General believes included statements which had the tendency or capacity to

mislead potential borrowers through claims that the consolidation loans would result in monetary savings to borrowers. Specifically, ISL's advertisement, attached as exhibit A, makes claims such as:

- a. "Save money when you lower your interest rate an additional 1%."
- b. "Start experiencing these savings in just six months!!"
- c. "Save over \$1,000 on every \$8,000"
- d. "Additional benefits to save even more on your consolidated loans"
- e. "Save \$2609 in interest on every \$10,000"
- f. "Save \$6,162 in interest on every \$10,000"
- g. "Have peace of mind knowing you are paying less because you locked in your rate at historic lows!"
- h. "Save *even more* with our special interest rate reduction program."

2. In fact, consolidating student loans almost always results in greater overall monetary payments compared to paying off the existing loans under their original terms in that when a borrower consolidates loans it generally extends the period of repayment in comparison to the period of repayment of the existing loans, generally resulting in a substantially increased payment of interest.

3. In addition, ISL advertised certain beneficial loan terms available to borrowers who made timely payments over certain periods of time, including lowered interest rates, but failed to clearly and conspicuously disclose the conditions on continuation of the benefits, including but not limited to that the beneficial terms were only available if the borrowers continued to make timely payments. ISL did disclose these conditions in the advertisements, but the location and type size

of the disclosures were not sufficient so as to be clear and conspicuous. The advertisements referenced in this paragraph are attached as exhibit B.

C. ISL's RESPONSE

ISL is not currently offering consolidation loans or on-time payment benefits, and is not currently advertising such products. Our response to the review of select past advertising practices is as follows. ISL's intent is to publish advertisements which provide sufficient information to minimize the chance of misunderstandings. ISL believes its advertisements complied with applicable regulations. In the advertisements in question, ISL included the following footnotes which were not required to be disclosed and were not included in most other lenders' advertisements:

Pertaining to lowering payment amounts by extending consolidation loan terms:

"Since you will be paying interest over a longer period of time, consolidation of your loans could increase the total amount repaid."

Pertaining to saving money through ISL's offer to reduce the consolidation interest rate:

"Savings equals the difference between the amount paid if no rate reduction were received and the amount paid if the .75% and .25% rate reductions mentioned above were received."

Pertaining to the loss of borrower benefits if the borrower is subsequently delinquent:

"The borrower must sustain on-time payments to retain the 2.50% interest rate reduction."

Because we share the goal of the Attorney General to provide clear information, and because we believe that our advertisements can be improved by a) enhancing our disclaimers; b)

making them more prominent in the future, and c) further outlining the basis of the comparison, we agree to do so.

The "savings" mentioned were the result of ISL's decision to charge a lower interest rate than was allowed under federal law. We included a comparison in the ad to show the value of this benefit. This type of comparison formed a benchmark upon which borrowers could compare multiple consolidation options.

We have provided disclaimers beyond the minimum information required, which are not disclosed by most other lenders, and have agreed to incorporate the improvements suggested by the Attorney General in any future advertising. We believe this demonstrates ISL's adherence to its non-profit mission.

D. TERMS OF AGREEMENT

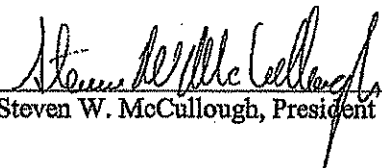
ISL agrees to the following:

1. ISL will not state or imply in advertisements of loans which consolidate other loans, that such loans will result in monetary savings for borrowers unless, either:
 - a. the consolidated loans actually result in a reduced monetary outlay for all borrowers over the full term of the loans in comparison to the loans prior to consolidation; or,
 - b. directly adjacent to each such direct or implied claim in an advertisement, and in the same type size, font, and shading, ISL qualifies the claim in language that is truthful, clear, concise and readily understood by potential borrowers to whom it is directed, and makes similar truthful, clear, concise and readily understood oral disclosures in any broadcast advertisement containing such direct or implied claim.
2. ISL will make every reasonable effort to avoid loan comparisons in its advertisements

unless the basis for the comparison is stated clearly, concisely, in a form that is readily understood by potential borrowers to whom they are directed and are made directly adjacent to any such loan comparison.


3. In any advertisement making direct or implied claims that ISL will lower interest rates or otherwise modify loan terms to benefit borrowers who meet certain conditions following commencement of loan repayment, ISL will state any material conditions on the availability and continuation of the beneficial terms directly adjacent to each such direct or implied claim, in the same type size, font, and shading and in language that is truthful, clear, concise and readily understood by potential borrowers to whom it is directed.

Iowa Student Loan Liquidity Corporation:

By: 
Steven W. McCullough, President & CEO

For the State of Iowa:

THOMAS J. MILLER,
ATTORNEY GENERAL OF IOWA

by: 
WILLIAM L. BRAUCH
Special Assistant Attorney General

9/18/08

ATTACHMENT 4

Suggested Model Policies for Private Student Lenders in Iowa

Lenders offering private student loans in Iowa should do so in a responsible manner, with the best interest of students and parents as the paramount goal. To reach this goal, lenders should adhere to the following policies:

- Students and parents will be advised to use all other sources of aid before utilizing private student loans. This includes verbal disclosures whenever students and parents call the lender to inquire about private loans.
- When possible, both fixed rate and variable rate options should be made available.
- Rates and fees should be as affordable as possible.
- Deferment time should be available, there should be no prepayment penalties, and the loans should be forgiven if the borrower dies.
- Parents or other credit worthy benefactors will be encouraged to borrow on the student's behalf *or to cosign the student's private student loans.*
- All interest rates, terms and conditions of the private student loan, and the criteria to qualify for them, should be fully disclosed before and at the time of application.
- All private student loan should be certified by the college financial aid office to ensure the loan is needed to pay for college, and to give the financial aid office an opportunity to first find other, more cost effective aid sources for the student before certifying the private student loan.
- All funds should be delivered to the college to ensure they are used for college expenses.
- Prior to accepting the borrower's application, the borrower should be advised to ensure that they understand the impact of their future loan payments on their living expenses. *Whenever possible, this counseling should be personalized to the individual borrower and include discussion of the total amount of interest that will be paid on the loan.*
- Lenders should not ask colleges to include private loans in the financial aid awards letters they send to families. They should encourage families to access all other means to pay for college before utilizing private student loans.
- The names or emblems of colleges should not be attached to private loans or their marketing materials.
- Lenders should not use give-aways to encourage the use of private loans or pay referral fees to students.
- Lenders should not sell private student loan borrower names to direct marketers.
- No compensation or cost reimbursement should be provided to colleges that process private loans, *or to college affiliated organizations.*
- *Comparisons of private loan programs should be based on the same number of years of repayment.*
- *Repayment examples involving loan discounts should be required to disclose the best, worst and typical figures for the discounts. Typical or average discounts should take into account the likelihood with which borrowers actually qualify for and obtain the specified discount.*
- *Lenders should not offer and colleges should not except private loan opportunity pools in exchange for placement of the lenders other loans on the college's preferred lender list.*

Adherence to these standards will engender the faith and trust of the public in Iowa lenders who adopt them.